HOUSE OF COMMONS LIBRARY

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Making Tax Digital

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Summary

In December 2015 HM Revenue & Customs published *Making Tax Digital* - its strategy to implement a new system of digital tax accounts to be used by businesses, the self-employed and landlords. The Government proposed that the new system would be rolled out over two years, first applying to income tax returns (in 2018), and then extended to VAT (in 2019) and corporation tax (in 2020).[1] Initially the Government anticipated that in the first phase from April 2018 businesses, self-employed people and landlords would be required to use digital accounts, updating HMRC on a quarterly basis; employees and pensioners would be exempt, unless they had secondary incomes of more than £10,000 per year from self-employment or property.

Following a consultation exercise last year, in the 2017 Budget the Government set out plans to roll-out digital tax returns from April 2018. To begin with unincorporated businesses and landlords would have to file income tax returns this way, if their annual turnover exceeded the VAT registration threshold – the point at which traders are requirement to account for VAT – although those with a turnover below this threshold would have another year to prepare. Businesses, self-employed people and landlords with turnovers under £10,000 would be exempt from these requirements.[2]

The Government anticipated that this new system for tax returns would substantially reduce the scale of taxpayer errors in record keeping, raising significant extra revenue for the Exchequer,[3] although some commentators have argued that the compliance burden on smaller businesses will be considerable.

Many stakeholders have also raised concerns about the potential impact of digital tax returns for taxpayers who may be digitally excluded, or have limited experience of using computers for their financial record keeping. HMRC's tax information & impact note on this reform, published alongside the Budget, notes the following:

> The government recognises that many people with disabilities use digital technology and are able to interact online using assistive technology. HMRC will ensure that available software will be compatible with forms of assistive technology and that those that are willing to operate Making Tax Digital for Business (MTDfB) are able to do so.
>
> Ofcom's 2016 statistics indicate that 59% of homes now own a tablet device and 71% of UK adults now have a smartphone. 97% of small and medium-sized businesses have access to online services. Although it is expected that the digitally excluded population will be relatively small, some of the segments impacted by the changes may be disproportionately represented within this population.
>
> Individuals with protected characteristics under the Equality Act who fall within the current legislative definitions of 'digitally excluded' will be exempted from the digital record-keeping and update requirements and HMRC will provide non-digital alternative channels to them … The government recognises by their very make-up that [the group of small and micro businesses] includes businesses which are likely to be more affected by one-off transitional costs and digital capability issues, and may therefore find it more difficult to move to the new digital requirements.

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1 HMRC, *Making Tax Digital – the roadmap*, December 2015 (see, Timeline, at pp11-12)

2 *Budget 2017*, HC 1025, March 2017 para 3.39. The report also confirmed that the VAT registration threshold would be increased from £83,000 to £85,000 from 1 April 2017 (para 3.36).

3 The Budget report estimated the Exchequer gain at around £1.9 billion over the period 2018/19 to 2021/22 (*op.cit.* Table 2.1- item 17; Table 2.2 – item bb).

> In the consultation the government said that it wanted to consult further on financial support to help some businesses make the transition to the new arrangements. It sought views on the support required and what form this should take ... The number of businesses and individuals affected and the impacts on them will be reviewed throughout 2017 as large scale piloting takes place in advance of MTDfB's mandatory introduction.[4]

The *Finance Bill 2017*, which was published on 14 March, initially included the first tranche of legislation to establish Making Tax Digital.[5] Following the Prime Minister's announcement, on 18 April, of the Government's intention to call a General Election on 8 June, the House completed all of the remaining stages of the Bill in the Commons on Tuesday 25 April. With cross-party support the Government removed a series of clauses from the Bill, with the intention of legislating for these at the start of the new Parliament, *including* these clauses. On this occasion Treasury Minister Jane Ellison said the following:

> The Bill is progressing on the basis of consensus and therefore, at the request of the Opposition, we are not proceeding with a number of clauses. However, there has been no policy change. These provisions will make a significant contribution to the public finances, and the Government will legislate for the remaining provisions at the earliest opportunity, at the start of the new Parliament.
>
> The Government remain committed to the digital future of the tax system, a principle widely accepted on both sides of the House. We recognise the need for the House to consider such measures properly, as called for by my right hon. Friend the Member for Chichester (Mr Tyrie) and his Treasury Committee. That is why we have decided to pursue those measures in a Finance Bill in the next Parliament, in the light of the pressures on time that currently apply.[6]

However, on 13 July the Financial Secretary to the Treasury, Mel Stride announced that the timetable for implementing MTD would be substantially amended:

> Under the new timetable:
>
> - only businesses with a turnover above the VAT threshold (currently £85,000) will have to keep digital records and only for VAT purposes
> - they will only need to do so from 2019
> - businesses will not be asked to keep digital records, or to update HMRC quarterly, for other taxes until at least 2020
>
> Making Tax Digital will be available on a voluntary basis for the smallest businesses, and for other taxes. This means that businesses and landlords with a turnover below the VAT threshold will be able to choose when to move to the new digital system. As VAT already requires quarterly returns, no business will need to provide information to HMRC more regularly during this initial phase than they do now. All businesses and landlords will have at least two years to adapt to the changes before being asked to keep digital records for other taxes.[7]

At this time the Government confirmed that provisions for the MTD programme would be included in a Finance Bill to be introduced "as soon as possible after the summer recess."[8] In turn this second Finance Bill was published on 6 September, and these provisions now form ss60-62 of the Finance (No.2) Act 2017.[9]

4 HMRC, *Making Tax Digital for business – tax information & impact note*, March 2017
5 specifically clauses 120-122, see the Explanatory Notes to the Bill (Bill 156-EN 2016/17).
6 HC Deb 25 April 2017 c1013
7 HM Treasury press notice, *Next steps on the Finance Bill and Making Tax Digital*, 13 July 2017
8 *Finance Bill: Written Statement*, HCWS47, 13 July 2017
9 These provisions were debated, and agreed without amendment, on division, at the Committee stage of the Bill: Public Bill Committee, Fifth Sitting, 24 October 2017 cc120-139

Subsequently at the time of the Autumn 2017 Budget HMRC published an updated impact assessment, which put the Exchequer cost of the new timetable at around £1.4 billion over 2019-2023.[10] HMRC now estimate that MTD will raise about £1 billion for the Exchequer by 2022/23.[11]

The revised timetable was welcomed by stakeholder groups, such as the Chartered Institute of Taxation, and the Low Incomes Tax Reform Group, though Members have continued to raise concerns as to the potential impact on taxpayers, especially smaller businesses.[12]

10 *Autumn Budget 2017*, HC587, November 2017 p30, Table 2.1 – item 67
11 HMRC, Making Tax Digital For Business – tax information & impact note, December 2017. See also, PQ127329, 26 February 2018.
12 See, for example, PQ4473, 20 July 2017; PQ10125, 9 October 2017; PQ115587, 30 November 2017

1. Background

1.1 Budget 2015: 'Making Tax Easier'

In his Budget speech on 18 March 2015 the then Chancellor, George Osborne, announced plans to introduce digital tax accounts, which would remove the need for individuals and small businesses to file an annual tax return:

> Some 12 million people and small businesses are forced to complete a self-assessment tax return every year. It is complex, costly and time-consuming. So, today I am announcing that we will abolish the annual tax return all together. Millions of individuals will have the information the Revenue needs automatically uploaded into new digital tax accounts. A minority with the most complex tax affairs will be able to manage their account online.
>
> Businesses will feel like they are paying a simple, single business tax, and again, for most, the information needed will be automatically received. This revolutionary simplification of tax collection will start next year, because we believe that people should be working for themselves, and not for the tax man.[13]

In a paper on its digital strategy published alongside the Budget report, HM Revenue & Customs stated that "By early 2016 five million small businesses and the first ten million individuals will have access to a secure, personalised digital tax account. By 2020 more than 50 million individuals and small businesses will have a secure, personalised digital tax account — removing the need for millions to complete a tax return and simplifying the tax system for millions more." The paper set out what taxpayers would be able to do with their own digital account:

1. View and manage their information online in one secure place
2. Pay the tax they owe without having to give HMRC information it already holds
3. Deal with their tax affairs quickly and easily
4. Use simple, clear and personalised support
5. Give authorised agents access to their digital tax account
6. Access a wider range of government services.[14]

In the Spending Review & Autumn Statement in November 2015, the Government published further details, including plans to "require most businesses, self-employed people and landlords to keep track of their tax affairs digitally and update HMRC at least quarterly via their digital tax account":

> The Spending Review and Autumn Statement announces that the government will:
>
> 1. invest £1.3 billion to transform Her Majesty's Revenue and Customs (HMRC) into one of the most digitally advanced tax administrations in the world, with access to digital tax accounts for all small businesses and individuals by 2016-17
> 2. by 2020, require most businesses, self-employed people and landlords to keep track of their tax affairs digitally and update HMRC at least quarterly via their digital tax account. HMRC will ensure the availability of free apps and software that link securely to HMRC systems and provide support to those who need help using digital technology. This will not apply to individuals in employment or pensioners, unless they have secondary

13 HC Deb 18 March 2015 c777. See also, *Budget 2015*, HC 1093, March 2015 paras 107-9
14 HMRC, *Making tax easier*, 18 March 2015 p8, pp5-6

> incomes of more than £10,000 per year from self-employment or property. The government will consult on the details in 2016.
>
> 3. consult on options to simplify the payment of taxes, including whether to align payment dates and bring them closer to the point when profits arise, so that taxpayers make a single regular payment that covers all their tax affairs.
>
> These reforms will deliver the biggest transformation of the tax system in a generation, making it more effective, efficient and easier for taxpayers, and are a first step by HMRC towards meeting a new target to reduce the costs to business of tax administration by £400 million by the end of 2019-20.[15]

The Government have suggested that mandatory digital accounts will reduce errors in tax returns, and raise over £600m by 2020/21.[16]

Further details of this costing were published at the time:

> **Making Tax Digital: reducing errors through record keeping**
>
> **Measure description**
>
> This measure will require businesses, self-employed people and landlords to integrate electronic record keeping with online tax reporting using business accounting software and to update their tax information at least quarterly to HMRC using these digital tools. The software, which will include apps for mobile devices, will include minimum standard functionality and data capture that prevents some error and promotes compliance. The use of software will reduce incidences of errors in tax returns, saving the public money.
>
> These requirements will apply to most businesses including companies, sole traders, self-employed people, partnerships and landlords. It will not apply to employees, or pensioners, with a secondary income source from self-employment or property and whose gross income from this secondary source is under £10,000 per year.
>
> The taxes in scope for this measure are Income Tax (IT), National Insurance Contributions (NICs), Corporation Tax (CT) and Value Added Tax (VAT).
>
> The measure will be implemented for IT and NICs from April 2018, VAT from April 2019 and CT from April 2020. The roll out will be staggered by regime and in each case the year prior to mandating for each regime will consist of testing amongst a limited cohort of customers.
>
> **The tax base**
>
> The tax base consists of the CT, IT, NICs and VAT lost due to non-compliance by small businesses as a result of error and failure to take reasonable care. The tax base grows over the forecast period in line with receipt projections and VAT theoretical liabilities.
>
> **Costing**
>
> The costing is estimated by applying a behavioural response to the proportion of the tax base impacted by this measure. This response captures the impact of taxpayers improving their compliance as a result of the measure through better, more timely record keeping and the prevention of some errors.

Exchequer impact (£m)

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Exchequer impact	0	0	neg	+10	+300	+610

15 *Spending Review & Autumn Statement*, Cm 9162, November 2015 paras 1.288-9
16 *op.cit.* para 3.93, Table 3.1 – item 20

> **Areas of uncertainty**
>
> The main uncertainties in this costing relate to the size of the tax base and behavioural response.[17]

As part of its work certifying the Government's policy costings, the Office for Budget Responsibility (OBR) assign each of these estimates a subjective uncertainty rating – and in this case, the OBR gave the costing a high uncertainty rating:

> **Making Tax Digital: reducing errors through record keeping:** This package receives a 'high' uncertainty rating. It is an HMRC initiative to interact digitally with small businesses across income tax, corporation tax and VAT, working with the private sector to introduce software that will design out record-keeping errors in taxpayers' returns.
>
> There are uncertainties in the behavioural response and operational delivery. In terms of behaviour, the uncertainty relates to the extent to which the software will prevent errors by taxpayers; in terms of deliverability, the uncertainty relates to whether HMRC can deliver this challenging project in time for the benefits to be realised as scored. Reflecting lessons learnt from previous costings …we paid particular attention to the degree of contingency built into the delivery plan before certifying the costing as central.[18]

1.2 Making Tax Digital: December 2015

In December 2015 Treasury Minister David Gauke, presented HMRC's plans for this five year programme: *Making tax digital*. In his speech the Minister addressed concerns that the introduction of digital accounts would impose significant administrative burdens on businesses:

> We will expect businesses to keep digital records and to update HMRC on a quarterly basis. But these updates will be done through software or apps and will be integrated into business' digital record keeping. And I want to stress that this is the end of the tax return – this is not going to feel like doing four tax returns a year. Indeed, we expect these reforms to ease the admin burdens on businesses and to help them plan their cash flow more easily, by providing greater certainty about what they will owe. Updating HMRC directly in this way will be secure, light-touch and far less burdensome than the tax returns of today.[19]

HMRC's document has more details on this mandatory reporting requirement, and how it would operate in practice:

> By 2020, most businesses, self-employed people and landlords will be required to keep track of their tax affairs digitally and update HMRC at least quarterly via their digital tax account. These changes will be introduced for some businesses from April 2018, and will be phased-in by 2020, giving businesses time to adapt.
>
> These businesses will be required to use digital tools, such as software or apps, to keep records of their income and expenditure. HMRC will ensure that free apps and software products are available, but many businesses and their advisers will choose to use commercially-available tax software packages. Businesses will use software that compiles their tax data as part of their ordinary day-to-day activity, highlighting any possible errors (for instance, arithmetical mistakes or figures which look out of place) and offering prompts for information that might otherwise be overlooked.

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17 HMG, *Spending Review and Autumn Statement 2015: policy costings*, November 2015 p27. See also, PQ22224, 18 January 2016.

18 "Certification of policy costings", in, *Spending Review and Autumn Statement 2015: policy costings*, November 2015 Annex A para A9. There is more on the OBR's assessment of previous costings at para A28.

19 HM Revenue & Customs press notice, *David Gauke sets out vision for making tax digital*, 14 December 2015

> Once the software has compiled the relevant data, businesses or their agents will feed it directly into HMRC systems via their computers or smartphones. Updating HMRC directly in this way will be secure, light-touch and far less burdensome than the tax returns of today. Businesses currently report information on tax returns and pay liabilities long after the end of the tax year. The government is changing the tax system so that it operates much more closely to 'real time'. Business will be able to see, through their digital accounts, a real-time view of their tax and a calculation of the tax due. By reporting information closer to real time, businesses will find it easier to understand how much tax they owe, giving them far more certainty over their tax position and helping them to budget accordingly.
>
> The government will consult widely on the details of these measures in spring 2016, including on whether they should apply to charities, sports clubs and their trading subsidiaries. The government has already announced, however, that these measures will not apply to individuals in employment or pensioners, unless they have secondary incomes of more than £10,000 per year from self-employment or property.[20]

However, several stakeholders raised concerns as to the potential compliance burden that MTD would imposed on the self employed, and small businesses,[21] and despite the Minister's assurance, over 100,000 people signed a petition calling on the Government to "scrap plans forcing self-employed & small business to do 4 tax returns yearly."[22]

The House debated this petition on January 25, when many Members raised constituents' concerns about the burden that digital tax accounts would impose on taxpayers, particularly on self-employed individuals. At the time accountancy bodies raised concerns that the case for compulsory quarterly reporting had not been made.[23] In his response to the debate Treasury Minister David Gauke reiterated the point that this measure would not mean 4 tax returns a year:

> I would like to make clear what "Making tax digital" is not and address some of the concerns raised by businesses. First … this transformation does not—I repeat "not"—mean four tax returns a year, but, by 2020, most businesses will be keeping track of their tax affairs digitally, updating HMRC at least quarterly via their digital tax account.
>
> Quarterly updates will not involve the complexity of a full tax return, where the business, or its agent, has to gather together and manually input data on to an electronic or paper form and then perform various calculations. Instead, updates will be generated from digital records and, in most cases, little or no further entry of information will be needed. It will be much quicker, easier and far less burdensome than the current process. The agony of the annual tax return will be a thing of the past.

The Minister went on to address why the Government believed that processing digital data would be an improvement for taxpayers as well as HMRC, and why, in its view, the project was deliverable:

> First, keeping records digitally will reduce error, partly because that will be done on a more timely basis. Secondly, the data will allow HMRC to focus its attention

20 HM Revenue & Customs, *Making tax digital*, 14 December 2015 p7
21 For example, Low Incomes Tax Reform Group (LITRG) press notice, *Pushing the digital tax account agenda could impose heavier burdens on self-employed*, 25 November 2015; Federation of Small Businesses (FSB) press notice, *Small firms will struggle with new quarterly tax returns, says FSB*, 14 December 2015
22 E-petition 115895, 17 June 2016
23 For example see, Chartered Institute of Taxation, *Westminster Hall debate - CIOT briefing*, 22 January 2016; LITRG press release: *Tax professionals issue warning about move to quarterly tax reporting*, 14 January 2016.

> on the small minority of small businesses that are evading their taxes, and not on those who are trying to get it right. One must also bear it in mind that the software will help taxpayers identify any errors in the information they provide. One of the key benefits permitted by a more digital approach is that errors can be spotted earlier by the taxpayers themselves ... One point that came up repeatedly … was that we are rushing this through. Let me reassure him and others that the Major Projects Authority has examined the plans and that it views them as deliverable … neither the Treasury nor HMRC are complacent … [but] it is worth noting that this is a five-year roll-out. We are engaging in substantial consultation this year. The piloting and testing of the technology and the various processes will then follow.[24]

In the 2016 Budget the Government confirmed that it would consult on detailed proposals for MTD later in the year, with a view to introducing the necessary legislation in Finance Bill 2017:

> **Making Tax Digital** – From 2018 businesses, self-employed people and landlords who are keeping records digitally and providing regular digital updates to HMRC will be able to adopt pay-as-you-go tax payments. This will enable them to choose payment patterns that suit them and better manage their cash flow. The government will also explore options to simplify the tax rules for these groups. The government will consult on these measures in 2016 alongside publishing detailed proposals for other elements of the Making Tax Digital programme announced previously. (Finance Bill 2017)[25]

1.3 Consultation on MTD & the Treasury Committee's inquiry (2016-17)

In August 2016 HMRC published six consultation papers on different aspects of the new regime.[26] The consultation period ran until 7 November.

One change the Government proposed was that all unincorporated businesses and landlords with gross income/annual turnover below £10,000 could be exempt, and that implementation could be deferred for a year a limited group of unincorporated businesses and landlords with annual turnover above £10,000 but below a set threshold. This announcement was welcomed,[27] though stakeholders argued that the Government's timetable for implementation was unreasonable,[28] and there continued to be worries that MTD would require quarterly tax returns:

> **Asked by Martyn Day :** To ask Mr Chancellor of the Exchequer, what assessment he has made of the implications for small businesses of his Department's plans to introduce quarterly digital tax returns by 2020.
>
> **Answered by: Jane Ellison :** The Government launched the Making Tax Digital consultations on 15 August. The consultations included an initial impact assessment alongside an overview of the potential costs and savings. This initial assessment shows a reduction in businesses' on-going administrative costs in the medium term; these proposals do not mean four tax returns a year. The Government will publish an updated assessment in the Tax Information and Impact Note to be published alongside draft legislation. These reforms will bring

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24 HC Deb 25/1/2016 cc35-6WH. In addition, HMRC published a one page brief to answer these concerns (*Making tax digital: myth-buster*, January 2016).

25 *Budget 2016*, HC 901, March 2016 para 2.212

26 HMT press notice, 15 August 2016

27 For example, CIOT press notice, 15 August 2016

28 LITRG press release, *Tax experts 'hugely concerned' with government plans for Making Tax Digital*, 8 November 2016; CIOT press notice, *UK Government must review unrealistic timescales for delivery of digitised tax system, say experts*, 9 November 2016; ICAEW press notice, *Take your time and implement a valued digital tax system, warns ICAEW*, 14 November 2016

> the tax system into the 21st Century, contributing to HM Revenue and Customs' overall target to reduce administrative burdens for business by £400m.[29]

The potential impact of MTD on taxpayers, particularly small businesses, proved to be a theme to [an inquiry by the Treasury Committee]() on UK tax policy and the tax base, initially launched in January 2016. Witnesses at two evidence sessions in September and October raised concerns,[30] – and following each session, the then Chair of the Committee, Andrew Tyrie, wrote to the Chancellor. In his second letter Mr Tyrie argued the following:

> It is clear from the evidence that the Committee heard that HMRC needs mandatory MTD to fulfil its business case for much needed investment in its IT. But it is equally clear that businesses will have to pick up the bill for this. The measure is therefore a transfer of the cost from HMRC to businesses. Given these points, the evidence we heard suggests that the introduction of MTD should not be rushed. Every effort should be made fully to pilot its introduction, perhaps over several years. Only after the lessons have been learned from the pilot should consideration be given to a mandatory scheme.[31]

Initially it was anticipated that the Government would announce its next steps by the end of the year, but the Government's response was delayed until the end of January 2017.[32] Prior to this, the Treasury Committee expressed serious reservations about the case for reform, particularly in relation to HMRC's assessment of businesses' compliance costs, and the proposed time frame for introducing digital tax returns, in a report published earlier that month; an extract is copied below:

> Digitisation will provide many opportunities for increasing efficiency of tax collection. This needs to be done not just in a way that may better secure the yield, but also taking into account the reasonable needs of millions of taxpayers. This will require a great deal of care and sensitivity on the part of HMRC. A large proportion of the UK's businesses, particularly the millions of small businesses, are not currently well equipped to move over to digital record keeping and reporting. Nor may they be so for several years …
>
> The imposition of a requirement to move to digital record keeping and reporting is a fundamental change to the system of tax administration in the UK which requires much wider debate and consultation. Even after the concessions announced to date, it is still likely to affect two and a half million taxpayers and possibly as many as five million. It is extremely unlikely that the vast majority of businesses will be capable of adapting to that start date at reasonable cost. Nor should they be expected to do so.
>
> The Committee therefore recommends a delay of the full implementation of MTD until at least 2019/20. In the view of the Committee, a start date of April 2018 for mandatory MTD is wholly unrealistic. Whether a start date of 2019, for the 2019/20 tax year, would be possible will depend on the exact shape of the Government's proposals. These have yet to be published. But on the evidence that the Committee has seen so far, this also looks unlikely …
>
> The average cost to business of implementing MTD cannot be substantiated until there is more detail of the requirements and more examples of the software. However, the cost is likely to be significant for a small business. There will be both implementation costs and continuing costs. Evidence given to the Committee suggests that under the current timetable, the total cost to business (including software, hardware, training, agent fees and, above all, time) might

[29] PQ 45742, 13 September 2016
[30] See, Treasury Committee, Oral evidence HC 314, 6 September 2016 (Qs227-250), and, Oral Evidence HC 314, 25 October 2016 (Qs 295-356).
[31] Letter from the Chair of the Treasury Committee to the Chancellor of the Exchequer re Making Tax Digital, 27 October 2016
[32] The delay was announced in the Autumn Statement (Autumn Statement Cm 9362, November 2016 para 4.42)

exceed the total benefits in improved tax yield. In other words, even if the yield were to rise, the return to the whole economy could be negative. The Government's estimate of the yield may therefore neglect the effect of overall behavioural changes.[33]

On 31 January HMRC published its responses to the summer consultation exercise; a summary was provided in a press notice:

After listening to the concerns of businesses and agents, HMRC can now confirm that under Making Tax Digital:

1. businesses will now be able to continue to use spreadsheets to record receipts and expenditure, which they can then link to software to automatically generate and send their updates to HMRC - this was requested by a wide range of stakeholders, particularly small businesses and the Treasury Select Committee
2. free software will be available to the majority of the smallest businesses
3. businesses that cannot go digital will not be required to do so
4. all self-employed businesses and landlords with a turnover under £10,000 a year will not have to keep their records digitally or make quarterly updates, but can do so if they wish
5. the option to account for income and expenditure on a simple 'cash in, cash out' basis will be extended, helping an extra 2.5 million self-employed businesses and unincorporated landlords
6. charities will not have to keep their records digitally or make quarterly updates
7. customers will have at least 12 months to become familiar with the changes before any late submission penalties will be applied; following feedback from respondents, HMRC will also consult again in the spring on a new penalty model
8. HMRC will pilot these digital systems with hundreds of thousands of businesses before rolling them out to ensure the software is user friendly, and to give businesses and landlords time to prepare and adapt

HMRC also confirmed that the government will need to consider further issues, such as the initial exemption threshold and deferring the changes for some small businesses alongside their cost, with final decisions to be made before legislation is introduced later this year.[34]

As noted here, the Government *postponed* a final decision on the question of setting an exemption threshold – the annual turnover threshold over which businesses would be required to file digital returns. The Financial Secretary underlined this point in a letter to the Treasury Committee at this time:

As you know, the MTD consultations also specifically explored the appropriate level of the initial exemption and deferral for the self-employed, landlords and businesses who will be in scope. Given the range of views expressed on this matter from respondents to the consultation and notably from your committee, the Government will take more time to consider these issues alongside the fiscal impacts. Final decisions will be made before legislation is laid later this year.[35]

33 "Conclusions and recommendations", *Making Tax Digital*, 14 January 2017, HC 927 of 2016/17 pp38-40

34 HMRC press notice, *Digital tax revolution moves a step closer*, 31 January 2017. HMRC also published a single overview document to its responses.

35 *Letter from Ms Jane Ellison, Financial Secretary to the Treasury, regarding Making Tax Digital*, 31 January 2017

2. Budget 2017

2.1 A one year deferral for the smallest businesses

In the 2017 Budget the Government stated it would defer mandatory digital tax returns for a year for unincorporated businesses & landlords whose turnover fell below the VAT registration threshold. Details are set out in a tax information & impact note published alongside the Budget, an extract from which is reproduced below:

> **Who is likely to be affected**
>
> Businesses, self-employed people and landlords will be required to start using the new digital service from:
>
> 1. April 2018 if they have profits chargeable to Income Tax and pay Class 4 National Insurance contributions (NICs) and their turnovers are in excess of the VAT threshold
> 2. April 2019 if they have profits chargeable to Income Tax and pay Class 4 NICs and their turnovers are below the VAT threshold
> 3. April 2019 if they are registered for and pay VAT
> 4. from April 2020 if they pay Corporation Tax (CT)
>
> Businesses, self-employed people and landlords with turnovers under £10,000 are exempt from these requirements.
>
> Those in employment who have secondary income of more than £10,000 per year through self-employment or property will also be required to use the digital service.
>
> In the consultation the government said that it was considering exempting more of the smallest unincorporated businesses from the requirement to keep digital records and make regular updates to HM Revenue and Customs (HMRC).
>
> The government announced at Spring Budget 2017 a one year deferral from the mandating of Making Tax Digital for Business (MTDfB) for unincorporated businesses and landlords with turnovers below the VAT threshold. This means that only those businesses, self-employed people and landlords with turnovers in excess of the VAT threshold with profits chargeable to Income Tax and that pay Class 4 NICs will be required to start using the new digital service from April 2018.
>
> **General description of the measure**
>
> The government recognises that the majority of businesses want to get their tax right, but the latest tax gap figures published by HMRC show that too many otherwise compliant businesses find this hard, even some who use an agent to help them. As a result over £8 billion a year in tax is lost from avoidable taxpayer errors. This not only costs the public purse, it also causes businesses cost, uncertainty and worry when HMRC is forced to intervene to put things right.
>
> HMRC wants to do more to help businesses get their tax right and these changes are a very important step in that direction. It will help businesses steer clear of avoidable errors, and give them a clearer view of their tax position in year.
>
> Businesses (including self-employed and landlords) will be able to keep records of their income and expenditure digitally, and send summary updates quarterly to HMRC from their software (or app).
>
> Those who genuinely cannot get online due to their individual circumstances such as disability, geographical, or other reasons, will be exempted from these obligations.[36]

[36] HMRC, *Making Tax Digital for business – tax information & impact note (TIIN)*, March 2017

This note went on to give details of the legislative changes that would be including in the forthcoming Finance Bill:

> **Legislation will be introduced in Finance Bill 2017 that will set out:**
>
> **Digital Record Keeping** - how to keep records of trading and transactions digitally, and categorise expenses with help from prompts and guidance in the software.
>
> **Establishing Taxable Profit** - how MTDfB would help establish taxable profit. In particular, exploring when businesses (including self-employed and landlords) should record accounting and tax adjustments for the purposes of arriving at a taxable profit and how businesses should reflect reliefs and allowances.
>
> **Providing HMRC with updates** - how businesses (including sole traders and landlords), would provide HMRC with quarterly updates under MTDfB. In particular, the level of detail the updates must contain, the time periods the updates cover, and when they should be submitted.
>
> **'End of Year' Activity** - how businesses might finalise their taxable profit for a period, including the activity they may need to undertake and how long they should have to do so.
>
> These changes will provide the legislative framework so that businesses will:
>
> - keep track of their tax affairs digitally using software or apps (digital tools). Regulations will specify what records must be recorded using digital tools
> - provide summary tax data to HMRC quarterly, using digital tools. The summary tax data will be automatically generated for the business from the electronic records. For VAT, these quarterly updates will effectively replace the VAT return. For Income Tax and CT, these updates will cumulatively build an in-year picture of the business' tax position for them
> - gain a clearer view of their tax position in-year
> - provide a finalised end of year position to HMRC of their tax affairs, again using digital tools. This obligation will apply ten months after the fourth quarter referred to above and will crystallise the taxable profits of that business for the previous year. For many businesses, this will simply be a matter of checking and agreeing the total for that year, based on the information which they have provided in the relevant four quarters. For businesses with more complex affairs, this will provide an opportunity to add and apply annualised reliefs and allowances for the period which would not have been reflected in the summary updates.[37]

The Chartered Institute of Taxation summarised the changes in their response to the Budget in a press notice:

> The Chartered Institute of Taxation (CIOT) welcomes today's announcement by the Chancellor of the Exchequer that, for businesses trading below the VAT registration threshold, the mandatory requirement to maintain digital records and submit quarterly updates will be deferred from April 2018 to April 2019 ...
>
> Adrian Rudd, Chairman of the CIOT's Digitalisation and Agent Strategy Group, said: "This announcement by the Chancellor recognises the challenges which will be faced by the many small businesses who are not currently maintaining digital records or interacting with HMRC on a frequent basis. The software being developed for MTD is not yet ready, and indeed may not be fully available until late 2017. Whilst testing of MTD software will take place on an increasing scale throughout 2017 and early 2018, it makes no sense for the government to require small businesses, which are likely to suffer the greatest proportionate impact, to be at the vanguard of MTD."

[37] *Making Tax Digital for business – tax information & impact note (TIIN)*, March 2017

> The exemption from MTD for the self-employed and landlords also appears to have been confirmed at £10,000 per annum, in line with previous announcements.
>
> **The main timescales for mandation into MTD will therefore be:**
>
> - **April 2018** – Unincorporated businesses with a turnover above the VAT registration threshold, for their Income Tax obligations[38]
> - **April 2019** – Unincorporated businesses with a turnover above £10,000 but below the VAT registration threshold for their Income Tax obligations, PLUS all businesses (unincorporated and incorporated) for their VAT obligations
> - **April 2020** – All incorporated businesses for their Corporation Tax obligations
>
> Adrian Rudd said: "Notwithstanding this very welcome relaxation for small businesses, the timetable for MTD remains extremely challenging. The many complexities of tax still need to be translated into functioning software, and the diverse nature of businesses accommodated, not to mention how their agents can support them. We would encourage HMRC to step-up their engagement with professional bodies, agents, software companies and businesses themselves. Success of MTD will only come from real collaborative working with all stakeholders."[39]

As noted, in January this year HMRC published its responses to the consultation exercise on MTD. As part of this, HMRC had asked for views on how it should support taxpayers who might have difficulties from using digital tax returns – either with the financial costs of these new requirements, or more generally with the practical problems of filing digitally. In the first case, HMRC had asked, "what level of financial support might it be reasonable for the government to provide towards investing in new IT, software or training, to whom should such support be aimed, and what is the most appropriate form for delivering such support?"

> There were 150 responses to this question.
>
> A wide variety of options was offered in response to this question, ranging from £1,000 to £30,000 for 'one-off costs' and between £100 and £1,000 per year for running costs. Some respondents believed that because the government is mandating MTDfB, it should be responsible for all associated costs, including training; others felt that there should be no recourse to public funds. Some respondents suggested that there should be some form of incentive through either tax credits, redeemable vouchers, a tax deduction, enhanced capital allowances or non-taxable grants. Nevertheless, it was recognised this should be targeted at smaller businesses and monitored to ensure that public money was not being abused.
>
> Some respondents believed that any financial support should be adequate to enable the business owner to receive appropriate training and acquire extra IT equipment as necessary. Some suggested that if the exemption threshold rises, the range of those needing help might also expand. Others thought that additional tax relief should be considered to cover training costs for the first 24 months of MTDfB, or from the start of a new business.
>
> Some respondents suggested that there might be an extended phasing-in period which offered a fixed sum deduction from tax, for example, £500 technology deduction, which would apply to businesses below, say, the cash accounting level. Alternative suggestions included offering an integrated financial package of

[38] An exception to this is that 'complex' partnerships, defined as those with a turnover exceeding £10,000,000 per annum, will be mandated into MTD in April 2020.

[39] CIOT, *CIOT welcomes deferral of Making Tax Digital obligations for small businesses*, 8 March 2017. See also, "Harness the power", *Taxation*, 30 March 2017.

> support, including low cost digital skills training, plus affordable broadband options being made available and promoted.[40]

HMRC had also asked "what other forms of support would help to make the transition to Making Tax Digital easier?":

> There were 115 responses to this question.
>
> Other forms of support that would help make the transition to MTDfB easier included:
>
> 1. face-to-face seminars and tutorials
> 2. dedicated, free, HMRC telephone helplines, open from 8am to 8pm
> 3. expert advice provided free of charge
> 4. group training sessions provided by HMRC, for those without digital skills
> 5. user-friendly printed manuals, as well as a "welcome" pack containing information about MTDfB and signposting places to go to for help
> 6. guaranteed broadband speed and reliability
> 7. clear and simple communication, including information forums.
>
> Agent respondents felt that they also needed help and training about the future requirements of MTDfB, in order to support business owners. Several respondents pointed to the Australian Tax Office programme of engagement, which included workshops, videos and newsletters, to engage with and educate the business community about MTDfB. Another suggestion was that HMRC should provide some form of accredited training. In addition, some suggested that HMRC should consider providing a stand-alone website that would not only raise the profile of MTDfB, but also assist businesses in choosing products and services.[41]

The Government's response to the points made to these two questions was the following:

> The government recognises that it is essential businesses get the help and support they need to make MTDfB successful for them. Over 1 million small businesses accessed digital help and support from HMRC last year and HMRC will build on this to ensure that the right help is available in a range of ways and through a range of channels to ensure it meets the diverse needs of the business and agent populations. In particular, help needs to be targeted at those businesses that have the most need of it. HMRC will carefully consider the suggestions made, and final decisions will be made before legislation is laid later this year.[42]

One other issue that was raised as part of HMRC's consultation was the role of penalties, for late submission of digital returns and for late payment of tax. In January 2017 HMRC stated that "to support customers during the transition to the new MTD obligations, customers will be given a period of at least 12 months before they will be charged late submission penalties under MTD", and that, in response to feedback, it would have a further consultation later in the year.[43] This follow-up consultation was launched after the Budget; responses were invited by 11 June.[44] To date no further details have been published.

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40 *Making Tax Digital - Bringing business tax into the digital age - Summary of responses*, January 2017 pp13-4
41 *op.cit.* p.14
42 *op.cit.* pp14-15
43 *Making Tax Digital: Tax administration - summary of responses*, 31 January 2017 para 3.4
44 *Making Tax Digital: sanctions for late submission and late payment*, 20 March 2017

2.2 Discussion of compliance costs, mandatory returns, and Exchequer yield

A few days after the Budget the House of Lords Economic Affairs Committee, published a report on Making Tax Digital, which picked up this question of supporting businesses with their compliance costs:

> In its August 2016 consultation, HMRC … suggested that financial support might be provided to businesses to assist with their transition and additional costs. An announcement on this was expected around the time of the Spring Budget 2017, but is still awaited. Speaking for the Low Incomes Tax Reform Group (LITRG), Robin Williamson made the case for financial support particularly in relation to assistive technology for those with disabilities.
>
> More widely, in the Digital Economy Bill 2017 the Government plans to make training in basic digital skills free for adults lacking relevant qualifications. The details of this training and the level of qualification to which the new duty will apply will be the subject of future consultation.

The Committee expressed the view that there was "insufficient publicly available information on HMRC's strategy and resources for providing support to different taxpayer groups, or to tax agents and software providers" and recommended that, "HMRC urgently develops, and publicises: an updated assessment of the various types of support that different types of businesses are likely to need; and, its wider plans for meeting those needs, including IT and bookkeeping training."[45]

The Committee also expressed wider concerns as to the Government's position on making the filing of digital tax returns mandatory:

> The almost universal concern of witnesses is that the current timetable for mandating digital record keeping and quarterly reporting is too tight and entails unjustifiable risks for businesses, HMRC, tax practitioners and the software industry. It does not allow enough time for full end-to-end piloting and evaluation to avoid unnecessary risks for both HMRC and businesses.
>
> We welcome the Chancellor's decision to defer until 2019 the mandation of the smallest businesses into the new system. This will help address some of the most pressing concerns by reducing the risks of unnecessary costs and implementation difficulties for these businesses.
>
> However, the Chancellor's changes do not go far enough. We recommend that mandatory implementation of digital record keeping and quarterly reporting should be deferred until April 2020, after the extended pilot period.[46]

Notably the Committee's recommendation for a delay in the rollout of MTD was strongly welcomed by several stakeholders – both the CIOT and LITRG, as well as the Association of Taxation Technicians (ATT):

> **Yvette Nunn, Co-chair of ATT's Technical Steering Group, said:** "The report should give the Government the impetus to tap on the brakes on this juggernaut, to allow more time for full end-to-end testing, piloting and evaluation to avoid unnecessary logistical and financial risks for both HMRC and businesses. We support concerns in the report that the Government's estimate of the 'tax gap' savings are fragile and not based on 'adequate evidence'. Similarly, we are highly sceptical of HMRC's assertion that the scheme will initially cost businesses on average just £280, a figure that does not reflect the reality of the initial expenses businesses will incur.

45 *Draft Finance Bill 2017: Making Tax Digital for Business*, 17 March 2017, HL 137 of 2016/17, para 116-9

46 *op.cit,* para 153-5

> "We welcome the committee highlighting that the difference between the rules for choosing to apply the cash basis to trading income and to property income, is a potential source of confusion and error for many businesses, especially those with income from both sources." [Based on the draft legislation published on 31 January, businesses will have to opt out of the property cash basis (i.e. the cash basis will be the default basis of accounting), whereas businesses currently have to opt in to the trading cash basis (i.e. Generally Accepted Accounting Principles – GAAP – is the default basis).]
>
> **Adrian Rudd, Chairman of the Joint CIOT and ATT Digitalisation and Agent Strategy Group, said:** "We welcome the committee's recognition of the unprecedented technological and logistical challenges which will be faced by the many small businesses and landlords which are not currently maintaining digital records or interacting with HMRC on a frequent basis. The timetable for MTD remains extremely challenging and a delay would enable the diverse nature of businesses affected to be addressed and a little more consideration of how their tax agents and accountants can support them. A full pilot would ensure the software is ready and works."
>
> **Anthony Thomas, Chairman of LITRG, said:** "Like the committee, LITRG believes that a digital programme, implemented with care and sufficient regard for the needs of the taxpayer, can greatly improve the administration of tax. We welcome the Chancellor's Budget announcement that businesses with a turnover below the VAT limit will have an extra year before being required to keep digital records and report to HMRC each quarter, but agree with the committee that this does not go far enough; the digital programme should be optional for businesses below the VAT threshold, for people will naturally gravitate towards systems that are good, intuitive and easily navigable, without the need for compulsion.
>
> "We also concur with the committee's recommendation that HMRC urgently assess and make public how it intends to support the digitally assisted population, and business owners with disabilities that require the use of assistive technology."[47]

HMRC's impact assessment also provides figures of the projected Exchequer yield from this reform …

Exchequer impact (£m)

MTDfB reducing errors through record keeping

2017 to 2018	2018 to 2019	2019 to 2020	2020 to 2021	2021 to 2022
-	+10	+400	+805	+965

MTDfB one year deferral for businesses with turnover below VAT threshold and Increase cash basis

2017 to 2018	2018 to 2019	2019 to 2020	2020 to 2021	2021 to 2022
negligible	-20	-65	-150	-45

… with details of how HMRC has approached estimating these numbers:

47 LITRG press notice, *Lords' call for delay to Making Tax Digital welcomed by tax professionals*, 17 March 2017

These digital reforms will contribute £1.9 billion to the Exchequer by 2021 to 2022. The MTDfB: reducing errors through record keeping costing was certified by the OBR at Autumn Statement 2015 and updated at Budget 2016 and again at Spring Budget 2017.

The costing has been updated to take into account latest tax gap estimates, receipts information, and including an additional year (2021 to 2022). The updated costing also includes changes to extend the exemption announced at Autumn Statement 2015 to include primary income, and to allow businesses currently using spreadsheets to record transactions to continue to be able to do so (however they must ensure that the spreadsheets meet the necessary requirements of MTDfB). All other assumptions remain the same.

In addition a subsequent MTDfB policy change was announced at Spring Budget 2017 which introduces a 1 year deferral for ITSA businesses and landlords with turnover below the VAT threshold. The costing for this is shown separately above.

The estimates represent net tax gap savings arising as a result of more timely and accurate record keeping. These revenue benefits are calculated following the general approach that is: revenue benefit = tax base x proportion of tax base covered x behavioural response.

Latest tax gap figures show the amount of revenue lost due to error and carelessness is now £8.7 billion (for 2014 to 2015), an increase of £0.5 billion on 2013 to 2014. To calculate the revenue benefit, assumptions were applied to break down the tax gap into revenue lost from small businesses within the scope of MTDfB, and due to errors and failing to take reasonable care. These were then projected forward to 2020 to 2021 by assuming that the relevant part of the tax gap will grow in line with the OBR's forecast tax liabilities.

Take-up rates were estimated based on the phased introduction of the changes, that is, Income Tax and NICs from April 2018, VAT from April 2019 and CT from April 2020.

The behavioural response is the proportion of tax loss that will be prevented as businesses change their behaviour as a result of the new requirements. This was estimated from a series of workshops with operational experts, reviewing risks found in enquiries and considering which are related to record keeping failures and how much they would be impacted. The estimates obtained were then validated against the existing research base.

There are three direct tax random enquiry programmes which are used to produce tax gap estimates. They cover:

- self assessment individuals and small partnerships
- small and medium-sized enterprises
- CT for small and medium-sized enterprises

Random enquiry programmes allow HMRC to estimate the extent of under-declaration of liabilities arising from the submission of incorrect returns. Each return selected is subject to a full enquiry involving a complete examination of books and records.[48]

Finally HMRC's impact assessment discusses at some length the question of MTD's compliance burden, with estimates of the numbers of taxpayers to be affected …

The changes will affect most businesses, including micro and small businesses, and we recognise that the population that will be affected is diverse. This includes around 3.3 million self-employed individuals (including around 900,000 landlords), 1.6 million companies, over 400,000 ordinary partnerships, and about

[48] *Making Tax Digital for business – tax information & impact note (TIIN)*, March 2017

> 600,000 businesses with income from different sources (for example, both self-employment and property) …

… and details of HMRC's 'Standard Cost Model', which underpins HMRC's quantification of the costs businesses will incur:

> Our analysis of the ongoing impact on administrative burdens uses the Standard Cost Model (SCM). The SCM represents the cost of complying with the tax system for a normally efficient business. This provides a consistently calculated and informed set of estimated costs for each tax obligation, averaged across the entire business population.
>
> The assessment brings into the model the full range of tax and NICs obligations covering the majority of the unincorporated business population.
>
> Changes in time for existing obligations are considered in conjunction with estimates of additional ongoing software costs, and the burden of quarterly updating, to provide the overall administrative burden impact.
>
> Once all businesses complying with the new requirements have fully transitioned, and are making full use of software capabilities, steady state savings associated with an overall reduction in time spent complying with existing ITSA and VAT obligations, plus the complete removal of certain obligations, are estimated at £270 million.
>
> The SCM provides the estimated costs for a proportion of businesses incurring ongoing software and external agent costs as a result of complying with these obligations, and until behavioural responses to these digital reforms are better understood, these costs are maintained at current levels. Costs are then estimated for increased software subscription costs, and making quarterly updates. Steady state costs are estimated at £170 million.
>
> This produces a net administrative burden saving of £100 million (steady state in 2021 to 2022). HMRC has profiled these estimates using take-up assumptions over the period from 2017 to 2018 to 2022 to 2023.
>
> Estimated costs depend on final software solutions, the availability of free software and individual providers' pricing structures. The government recognises that this produces a broad estimate, and so we will review and test this analysis and our assumptions through ongoing extensive engagement and consultation with businesses, and through further research and analysis.
>
> This means that the final estimate of the savings and costs to business could be different from the estimate presented here.
>
> It is also expected that businesses will incur transitional costs in moving to the new arrangements. Our current estimate is that the transitional costs average about £280 per business (in their year of transition) over the period 2017 to 2018 to 2020 to 2021.
>
> The costs are likely to cover:
>
> - time spent in familiarising themselves with the new digital tools and quarterly submission of information
> - purchase of new apps and upgrading existing software. This will depend on what free software is available from the market, and take-up
> - a small minority of businesses may need to purchase new hardware or upgrade existing hardware
> - additional accountancy / agents costs
>
> The assessment of the MTDfB impacts over the 6 year period to 2022 to 2023 is below: Note that the presented figures have been individually rounded to the nearest ten million and therefore may not sum to the net burden impact.

Current breakdown of Administrative Burden costs and savings (all £m)

Profile (£m)	2017 to 2018	2018 to 2019	2019 to 2020	2020 to 2021	2021 to 2022	2022 to 2023
Steady state costs	-	£50	£150	£170	£170	£170
Administrative burden savings	-	-	-£150	-£270	-£270	-£270
Transitional costs (one-off)	£100	£200	£590	£100	-	-
Net impact	£100	£250	£590	£0	-£100	-£100

[49]

As noted in this, HMRC estimate that the transitional costs will average £280 per business, while the Federation of Small Businesses has published estimates putting this figure at £2,770 per year per business.

In February 2017 the Chair of the Treasury Committee, Andrew Tyrie, wrote both the Financial Secretary and the FSB to ask for details as to how these very different estimates were made – and in turn the Committee has recently published the responses it received. In her reply the Financial Secretary provided a detailed memorandum from HMRC, and this material is reproduced in the annex to this note.[50] Following this correspondence, the Committee Chair, Andrew Tyrie, gave a statement:

> "There are huge differences between the FSB and HMRC about the administrative burden of Making Tax Digital. This is the heart of the matter. The FSB think that with MTD, businesses might spend three times as much time on their tax obligations as they currently do. This could cost them around £3,000 a year in time, salaries and accountants' fees. HMRC think that they will spend less time, leading to a small net saving.
>
> A comprehensive pilot should shed some light on which assumption is closer to reality. This serves to illustrate the need for the implementation of one of the Committee's recommendations that a comprehensive pilot is needed to establish the facts, and before mandatory roll out of the digital regime.
>
> I have written to the Administrative Burdens Advisory Board to ask for a view on the basis of their members' extensive business and accountancy practice networks."[51]

2.3 Response to the Treasury Committee's report

Following this, the Government's response to the Committee's report on MTD was published on 18 April.[52] As noted, in January the Committee had raised a series of concerns about MTD, including its timetable, the level of the exemption threshold, the question of making digital tax returns mandatory and the provisions to exempting 'digitally excluded' taxpayers, as well as the likely compliance costs for business. Some extracts from the Government's response are reproduced below.

First, on the timetable for MTD, the Committee had argued that the start date of April 2018 was "wholly unrealistic". In response the Government argued that its

49 Making Tax Digital for business – tax information & impact note (TIIN), March 2017
50 Treasury Committee, Updated HMRC Impact Assessment on Making Tax Digital for Business, 21 March 2017
51 Treasury Committee press notice, Correspondence on Making Tax Digital published, 27 March 2017
52 Treasury Committee, First special report, 18 April 2017, HC 1135 of 2016-17

revised timetable, giving the smallest businesses a further year to prepare, was "realistic and achievable for businesses, agents and HMRC":

> Ministers and HMRC have engaged extensively with a wide range of stakeholders to ensure that the new system reflects their input. HMRC is on track to commence the large scale pilot from April 2017, allowing a full year of testing and refinement of the MTD service before mandation of those above the VAT threshold in April 2018. There will be two full years of testing before businesses with turnover below the VAT threshold are required to keep their records digitally and update HMRC quarterly, from April 2019. The end of year process will be tested fully before any business or landlord is required to use it (for those mandated to join MTD for Business in April 2018 that testing needs to happen before 31 January 2020).
>
> As well as enabling the testing of the digital systems, the pilot will also test and develop the support for businesses and agents to help them transition smoothly to MTD. The Government recognises this is essential to land MTD successfully.[53]

On mandation and the exemption threshold, the Committee had taken the view that imposing MTD on "many businesses whose profits are far less than the personal allowance … would palpably be absurd." It noted that aligning the thresholds for MTD and VAT registration would be a "simplifying approach" and that it had "heard no strong evidence to setting it at a lower level." In response the Government stated, "the exemption threshold was set after considering evidence about the size of the population affected in relation to their share of the tax gap":

> Each year HMRC conducts enquiries into a sample of randomly selected businesses, and uses the information gathered to understand the scale of non-compliance, including estimating the tax gap. This work has consistently shown that businesses operating below the VAT threshold contribute around 80% to the income tax self-assessment business tax gap. The potential tax loss from error and carelessness in the small businesses population is projected to grow to around £7bn-£8bn per annum between 2017/18 and 2021/22.[54]

On digital exclusion the Committee argued that HMRC should provide clear guidance on the scope of this exemption, and suggested that it might be preferable to have "more extensive transitional arrangements" rather than extending the scope of exemptions. In response the Government said:

> The Government will provide for an exemption for digitally excluded customers which will apply when one of two criteria is fulfilled. Either (1) for any reason (including age, disability or location) it is not reasonably practicable for the person or partner to use electronic communications or to keep electronic records; or (2) the person or partner is a practising member of a religious society or order whose beliefs are incompatible with using electronic communications or keeping electronic records.
>
> The business will need to demonstrate a causal link between their particular circumstances and the impracticability of their using electronic communications or keeping electronic records. This approach is consistent with the existing exemptions to online filing for VAT and corporation tax, which work well.
>
> HMRC will ensure that clear guidance is available for all aspects of these reforms. This will include guidance for digitally excluded customers about the exemption. Where a business disagrees with an HMRC decision concerning the application of the exemption, they will be able to appeal this decision.

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53 *op.cit.* p2
54 *op.cit.* pp4-5

> HMRC will consider an application for exemption on its own merits, based against the criteria set out in the legislation. HMRC will ensure that the existing exemptions are applied consistently, fairly and in line with the existing case law.[55]

Finally, on compliance costs, as noted above, the Committee had questioned HMRC's estimates and argued that "before proceeding, the Government needs to provide further evidence that real time reporting does indeed provide the large yield claimed by them for it." The Committee also suggested that it was "plausible to suppose that, in so far as MTD results in fewer customer errors, those errors will have been as much in the Exchequer's favour … as they have been in favour of the individual taxpayers." In response the Government cited the additional evidence HMRC had provided the Committee, and reiterated that "HMRC is confident in its HMRC is confident in its estimates of the Exchequer benefits which at Spring Budget 2017, were estimated to contribute £1.9 billion to the Exchequer by 2021/22":

> The costing methodology for MTD was scrutinised and certified at Autumn Statement 2015 by the Office for Budget Responsibility (OBR) and the estimate of additional yield confirmed as central. OBR revisited the costing in 2016 and more recently at the Spring Budget 2017 including the 1 year deferral for unincorporated businesses below the VAT threshold (table 2.2 and table 2.1) where it was again judged a central estimate. Whilst the OBR certified (scored) the additional tax revenues from MTD for Business, and described them as a 'reasonable and central' estimate they gave the scoring a 'high' uncertainty ranking given the dependency on third party software preventing errors by taxpayers and the challenging scale and scope of what HMRC needs to deliver…
>
> Based on a comprehensive random enquiry programme, HMRC have consistently shown that businesses operating below the VAT threshold contribute around 80% to the income tax self-assessment business tax gap …
>
> The Exchequer benefits from reducing the tax gap arise from reductions in error and failure to take reasonable care through:
>
> - More timely record keeping through the use of digital tools such as software or apps; and
> - Updating HMRC on a quarterly basis with summary data produced from those digital records.
>
> To estimate the reduction in the error and failure to take reasonable care tax gap HMRC used two separate panels of experienced frontline staff to review the tax losses found in small business compliance checks. These numbers were then validated against a range of research, including previous surveys and interviews with small businesses. HMRC applied this to the tax gap estimate to develop the Exchequer impact, and then adjusted for a range of other behavioural factors. The methodology was reviewed by the OBR and stood up to that rigorous scrutiny.
>
> HMRC's estimates of the Exchequer impacts assume that some errors will result in less tax, not more. But most businesses filing returns will have tax to pay and their sales are worth more than their expenses.
>
> HMRC will, of course, continue to update its assessment in the light of any new evidence it gathers, for example, through the large scale public pilot.[56]

Following the Budget on 13 March the Treasury Committee took evidence from the Office for Budget Responsibility, and during the session, the OBR's Chairman, Robert Chote, was asked about the HMRC's estimate of the Exchequer benefit from

[55] *op.cit.* pp5-6
[56] *op.cit.* p7

MTDfB.[57] Subsequently Mr Chote wrote to the Committee, giving details of the way the OBR scrutinises policy costings …

> The scrutiny of policy costings is an iterative process: we are presented with an initial estimate, which we discuss with the relevant department and the Treasury, suggesting changes until we are happy to certify it as reasonable and central. For more complex costings, there are often multiple stages before we are prepared to certify them. This was the case with 'making tax digital'.
>
> When presenting a costing for a tax measure, we generally ask HMRC to set out the policy background and then identify the tax base - the monetary value of the financial stream or asset on which the tax is levied. The next step is a static costing - the estimated fiscal impact that the measure would have in the absence of any behavioural response. We then consider how behaviour might respond and how the costing should be adjusted to account for this.[58]

… and about its work certifying the costing for MTDfB:

> The element of 'making tax digital' for which we certified the costing at Autumn Statement 2015 is not a conventional tax measure, of the type that broadens or narrows an intended tax base or increases or reduces the rate of tax levied on that base. Rather it was designed to reduce taxpayer error and bring the amount of tax paid closer to that intended under the existing tax base and rate structure. But the costing follows similar principles.
>
> The first step was to estimate the amount of tax lost through error and failure to take reasonable care prior to the measure. At the time of the original costing (November 2015), HMRC's most recent estimate was £4.5 billion in 2013-14. This was then grown in line with our forecasts at the time for the relevant tax streams, increasing the estimated loss to £5. 7 billion by 2020-21.
>
> The introduction of digital record-keeping was then assumed to reduce taxpayer errors, with the removal of those errors favouring the taxpayer outweighing the removal of those favouring the Exchequer - thereby delivering a positive yield. This judgement was based on two pieces of qualitative research, one commissioned by HMRC and another by the Office of Tax Simplification. Leaving aside deliberate non-compliance, errors are assumed on balance to be in taxpayers' favour because most businesses filing returns will have tax to pay, with sales that exceed expenses.
>
> If record-keeping errors are of the same proportion in both sales and expense invoices, this results in a net under-declaration of tax liabilities. That said, the costing did take account of the removal of some errors that favour the Exchequer. The costing was also adjusted for the expected evolution of take-up. Although digital record-keeping is mandatory for those in scope of the measure, take-up was assumed to increase from the initial testing phase to full mandation. Take-up was also adjusted for the staggered start dates for SA, VAT and CT.
>
> When we certified this costing we gave it a 'high' uncertainty ranking, based on the potential behavioural response and concerns over the delivery Office for Budget Responsibility timetable. In terms of behaviour, the uncertainty relates to the extent to which the software will prevent taxpayer errors. In terms of deliverability, the uncertainty relates to the challenging scale and scope of the project Reflecting lessons from previous costings, and the experience of delays in the rollout of a number of welfare spending reforms, we paid particular attention to the degree of contingency built into the delivery plan before certifying the costing as central. That included evidence from a Major Projects Authority review. We continue to monitor progress against the plan at each forecast.[59]

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57 Treasury Committee, *Oral evidence: Budget 2017*, HC 1069, 13 March 2017 (see Qs 38-57)
58 *Correspondence from the Chairman of the Office for Budget Responsibility relating to the Committee's Budget 2017 inquiry*, 24 April 2017 p2
59 *op.cit.* pp2-3

During the evidence session, Mr Chote was also asked about the different estimates that had been made of the compliance burden for small businesses, and his letter goes on to address this:

> The official Government estimate of this burden is significantly lower than that produced by the Federation of Small Businesses, which was referenced in questions to us at the 13 March hearing. We did not scrutinise the Government's estimate, as it did not constitute part of the policy costing for the digital record-keeping element that is currently factored into our forecasts …
>
> Regardless of which of these estimates is a better reflection of the true administrative cost or gain to small business of 'making tax digital', neither is comprehensive in terms of measuring the wider economic impact. As such, they do not provide a sound basis for considering the wider economic effects. For example, if a small business incurs additional costs from purchasing new software or requiring accounting advice on a quarterly rather than an annual basis, those costs will represent additional revenue for the providers of the software or accountancy services. It is the net effect of these flows that will determine any impact on the wider economy. It seems likely that this would be negligibly small at the whole economy level.[60]

As noted, the then Chair of the Treasury Committee, Andrew Tyrie, had asked the Administrative Burdens Advisory Board (ABAB) for its view of the different estimates that HMRC and the FSB had made as to the administrative costs of MTD. In turn the Chair of the ABAB, Teresa Graham, wrote to Mr Tyrie, setting out the Board's view that while the FSB had overestimated the costs, HMRC had underestimated the amount of checking businesses would want to do, and that in setting out its figures HMRC "have given themselves a target to deliver against"; an extract from Ms Graham's letter is reproduced below

> The two papers approach the issue from different starting points. HMRC have done an internal analysis using their SCM approach to estimate costs and have done so in careful stages. The FSB have surveyed members and asked for views on current costs from those who will have to do the compliance and who are currently doing the necessary compliance under the current system. Both approaches are in principle valid.
>
> Any estimates of MTD costs at this stage will suffer from the facts that there are no products yet available to really use in modelling or testing and that the exact requirements for filing are not yet set …
>
> HMRC rightly assume that producing four updates a year - the core of MTD - will not each require similar effort to that currently expended on tax returns. Here, we think, the FSB has overestimated the costs (even though they have used a multiplier of three rather than four). However, we do think that HMRC has underestimated the amount of checking that business will want to do - either themselves or through their agents - for the MTD submissions. This will probably tail off once businesses become familiar with MTD and become more confident in the system but will be a part of the transitional costs at least.
>
> We cannot say that either of the papers represents the true picture of MTD costs. Nor would you expect us to. Whilst we believe that HMRC's analysis is more scientific and structured than that of the FSB, we would urge them to apply more granularity to the numbers thereby placing less reliance on the SCM model which we believe results in too much optimism …
>
> Our overall conclusion is that HMRC, in setting out these figures, have given themselves a target to deliver against. They and the FSB should commit to monitoring the costs as MTD is implemented and the Government should commit to a full post-implementation review (PIR) of MTD in the light of the first couple of years' experience. As ABAB have said before, such PIRs are too rare

[60] *op.cit.* p3

> with changes to the UK's tax system and need to become routine so that proper lessons are learned and, if necessary, adjustments made.[61]

Following the Budget, the Treasury Committee took evidence from the ATT, CIOT and the ICAEW on 18 April. As part of this, Kit Malthouse asked about the Government's announcement in the Budget of a one-year delay for businesses with turnover under the VAT registration threshold. In response Nick Parker, Deputy President of the ICAEW, said: "we were very pleased that the Minister had listened":

> Just bringing in this £10,000 threshold was frankly ludicrous and there needed to be much more time. Talking to my counterpart at CIOT, he has just been to Australia, and the Australians are introducing a similar thing but they are doing it in a slower way. They are tiering it; they are bringing the larger businesses in first … to make sure that they get the system working right before the vast majority come in.[62]

Mr Tyrie asked Mr Parker if the Committee could have some further information on the differences in the approach taken by the authorities in Australia, and John Preston, Deputy President of the CIOT, wrote to the Committee a few days later; an extract is reproduced below:

- Crucially, the Australian system is not being seen or driven as a significant opportunity in itself to achieve an early reduction in the tax gap.
- Accordingly, there is no attempt to make quarterly record keeping compulsory for smaller businesses before focusing on larger businesses
- There is a recognition that allowing tax agents to have full access to their clients' records etc from day one is a fundamental and necessary requirement to the scheme's success
- The time frame over which changes are being introduced is less stringent (although the one year deferral introduced in the recent Budget has helped ease concerns in this respect).
- In fairness, the approach in the UK seems to be a more structured and holistic approach than that which has so far been undertaken in Australia, but that does not detract from the significance of the issues identified. [63]

2.4 *Finance Bill 2017*

The *Finance Bill 2017*, which was published on 14 March, initially included the first tranche of legislation to establish Making Tax Digital - specifically clauses 120-122.[64]

Following the Prime Minister's announcement of a General Election on 8 June, the House completed all of the remaining stages of the Bill in the Commons on Tuesday 25 April.

With cross-party support the Government removed a series of clauses from the Bill, with the intention of legislating for these at the start of the new Parliament, *including* these clauses. On this occasion Treasury Minister Jane Ellison said the following:

> The Bill is progressing on the basis of consensus and therefore, at the request of the Opposition, we are not proceeding with a number of clauses. However, there

61 Treasury Committee, *Correspondence with the Chair of the Administrative Burdens Advisory Board relating to Making Tax Digital*, 11 April 2017
62 *Oral evidence: Budget 2017*, HC 1069, 18 April 2017 Q228
63 Treasury Committee, *Correspondence with the Deputy President of the Chartered Institute for Taxation relating to Making Tax Digital*, 26 April 2017
64 Details were given in the Explanatory Notes to the Bill – Bill 156-EN 2016/17.

> has been no policy change. These provisions will make a significant contribution to the public finances, and the Government will legislate for the remaining provisions at the earliest opportunity, at the start of the new Parliament.
>
> The Government remain committed to the digital future of the tax system, a principle widely accepted on both sides of the House. We recognise the need for the House to consider such measures properly, as called for by my right hon. Friend the Member for Chichester (Mr Tyrie) and his Treasury Committee. That is why we have decided to pursue those measures in a Finance Bill in the next Parliament, in the light of the pressures on time that currently apply.[65]

2.5 Announcement of a new timetable

In the weeks after the passage of the *Finance Act 2017*, there continued to be representations from stakeholders that the timetable for MTD should be delayed.[66] On 13 July the Treasury Minister Mel Stride announced that the timetable for introducing Making Tax Digital would be substantially amended:

> The government has listened to concerns raised by parliamentarians, in particular the Treasury Select Committee, businesses and professional bodies about the pace of change and is taking steps to ensure a smooth transition to a digital tax system …
>
> Under the new timetable:
>
> - only businesses with a turnover above the VAT threshold (currently £85,000) will have to keep digital records and only for VAT purposes
> - they will only need to do so from 2019
> - businesses will not be asked to keep digital records, or to update HMRC quarterly, for other taxes until at least 2020
>
> Making Tax Digital will be available on a voluntary basis for the smallest businesses, and for other taxes. This means that businesses and landlords with a turnover below the VAT threshold will be able to choose when to move to the new digital system.
>
> As VAT already requires quarterly returns, no business will need to provide information to HMRC more regularly during this initial phase than they do now. All businesses and landlords will have at least two years to adapt to the changes before being asked to keep digital records for other taxes …
>
> HMRC are fully committed to supporting businesses in this transition. HMRC has already begun piloting the Making Tax Digital services and will continue to do so, testing the system extensively with businesses. It will start to pilot MTDfB for VAT by the end of this year, starting with small-scale, private testing, followed by a wider, live pilot starting in Spring 2018. This will allow for well over a year of testing before any businesses are mandated to use the system.[67]

In a written statement the Government confirmed that it would introduce a Finance Bill, including provisions for the MTD programme, "as soon as possible after the summer recess":

> **Finance Bill: Written statement - HCWS47**
>
> The Finance Bill introduced in March 2017 provided for a number of changes to tax legislation that were withdrawn from the Bill after the calling of the general election. The then-Financial Secretary to the Treasury confirmed at the point they

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65 HC Deb 25 April 2017 c1013. In evidence to the Treasury Committee on 18 April, witnesses from the ATT, CIOT & ICAEW agreed that these clauses should be dropped from the Bill (Treasury Committee, *Oral evidence: Budget 2017*, HC 1069, 18 April 2017 Q241).

66 For example, "Ministers should delay MTD timetable", *Taxation*, 22 June 2017

67 HM Treasury press notice, *Next steps on the Finance Bill and Making Tax Digital*, 13 July 2017

> were withdrawn that there was no policy change and that these provisions would be legislated for at the first opportunity in the new Parliament.
>
> The Government confirms that intention. It expects to introduce a Finance Bill as soon as possible after the summer recess containing the withdrawn provisions. Where policies have been announced as applying from the start of the 2017-18 tax year or other point before the introduction of the forthcoming Finance Bill, there is no change of policy and these dates of application will be retained. Those affected by the provisions should continue to assume that they will apply as originally announced.
>
> The Finance Bill to be introduced will legislate for policies that have already been announced. In the case of some provisions that will apply from a time before the Bill is introduced, technical adjustments and additions to the versions contained in the March Bill will be made on introduction to ensure that they function as intended. To maximise certainty about the exact provisions that will apply, the Government is today publishing updated draft provisions.
>
> The Finance Bill will include legislation for the Making Tax Digital (MTD) programme. Having listened carefully to the concerns raised by the Treasury Select Committee, parliamentarians and stakeholders, the government is announcing policy changes that will be reflected in the legislation to be introduced. Businesses will not be mandated to use the MTD system until April 2019 and then only to meet VAT obligations. This will apply to businesses with turnover above the VAT threshold. Businesses with turnover below the VAT threshold will not be required to use the system but can choose to do so. Businesses will also be able opt in for other taxes, benefitting from a streamlined, digital experience.
>
> The Government will not widen the scope of MTD beyond VAT before the system has been shown to work well, and not before April 2020 at the earliest. This will ensure that there is time to test the system fully and for digital record keeping to become more widespread.[68]

Professional bodies widely welcomed the announcement of a revised timetable.[69] In a press notice the CIOT argued that MTD was much more likely to be a success by deferring mandation in this way:

> John Preston, CIOT President, said: "We are delighted that the government has relaxed the timetable for Making Tax Digital (MTD) and appears to be basing its approach on coaxing rather than compelling businesses into going digital. Whilst we are supportive of the government's long term ambitions for digitalising the tax system, we have always called for this to be achieved in a measured and manageable way. This deferral will give much more time for businesses, supported by their advisers, to identify for themselves, at their own pace, the benefits of digital record keeping. It will also ensure that many more software products can be developed and tested before mandation is reconsidered." …
>
> Adrian Rudd, Chair of the joint CIOT and ATT Digitalisation and Agent Strategy Working Group said: "Today's announcement by the Minister is extremely welcome, although there is still much to do to ensure MTD for VAT works effectively from April 2019. We look forward to continuing our constructive engagement with HMRC and other stakeholders to identify, and iron out, potential problems before the system is mandated."[70]

Welcoming the announcement Anne Fairpo, Chairman of LITRG, said:

> The deferral to at least 2020 for taxes other than VAT is welcome and should give enough time for thorough testing. It will also provide an opportunity for businesses to familiarise themselves with the systems well in advance. We have always maintained that a change of this magnitude should be well-planned.

68 *Finance Bill: Written Statement*, HCWS47, 13 July 2017
69 "Treasury delays plans to fully digitise business tax returns", *Financial Times*, 13 July 2017
70 CIOT press notice, *Delayed digital start date will make for better implementation*, 13 July 2017

> Preparation for the change should cover at least a full cycle of four quarterly reports and one year-end declaration to leave plenty of time to fix any malfunctions that emerge during the testing and allow users to become familiar with the systems.[71]

Similarly Graham Batty, President of the ATT, said:

> This is extremely welcome news … HMRC now have an opportunity to consider carefully how MTD might best be phased in. The deferral creates an opening for large-scale voluntary testing of MTD, followed by a proper evaluation of outcomes, so that the programme has the greatest possible chance of succeeding.
>
> Tax professionals must grasp the opportunity to work with HMRC to devise a version of MTD that is visibly 'doable' and works for their clients, the Exchequer and themselves. Many of our members have been gearing up for the introduction of MTD from April 2018. It is essential that HMRC harnesses that energy. It is also essential that HMRC has an adequate budget for a sustained publicity campaign to explain how and when MTD will be introduced and how businesses can prepare. Very few businesses currently understand the impact which the MTD obligations will have on them.[72]

Writing in *Taxation*, the magazine's editor Andrew Hubbard, argued that the new timetable was an opportunity for the Government to clarify the purpose of MTD:

> When first announced, MTD was trumpeted as a process that would benefit businesses by reducing their compliance costs. But those savings seem to have disappeared, at least in the early years because they are likely to be swallowed by set-up costs, and MTD is now being positioned as a system whose primary purpose is to help to close the tax gap.
>
> Agents are entitled to feel cynical about this complete turnabout and there is a considerable amount of trust to be re-gained. HMRC has an obligation to reduce the tax gap and if MTD has a role in this so be it. But nobody I have talked to has any confidence that the figures proposed are anything more than highly speculative.
>
> The role of the House of Commons' Treasury Select Committee in investigating the cost-benefit analysis of MTD for HMRC and taxpayers has been vital ... I hope that the new chair of the committee, Nicky Morgan, continues the fine work of her predecessor, Andrew Tyrie. Her committee will still need to look critically at the numbers, and not just those put forward by HMRC. It is right that it also tests assertions by taxpayers and their representatives.[73]

Another issue raised by Members has been the assistance that HMRC will provide businesses with the rollout,[74] and specifically, the supply of free software for smaller businesses:

> **Asked by Stephen Timms** : To ask Mr Chancellor of the Exchequer, by what date the free software promised by HM Revenue and Customs for smaller companies to comply with Making Tax Digital will be made available.
>
> **Answered by: Mel Stride** : HMRC is working very closely with the software industry to ensure a range of suitable products at a wide variety of price points is made available. Free software will be available for those businesses with the most

71 Low Incomes Tax Reform Group press notice, *A more measured start to Making Tax Digital will better serve its aims*, 13 July 2017

72 Association of Tax Technicians press notice, *Digital tax deferral offers chance to Make Tax Doable, says new ATT President*, 13 July 2017. See also, ICAEW press notice, *Government has listened on Making Tax Digital*, 13 July 2017.

73 "Hold your horses! Revised approach to Making Tax Digital", *Taxation*, 20 July 2017

74 For example, PQ4473, 20 July 2017

straightforward affairs who voluntarily choose to use Making Tax Digital to meet their Income Tax obligations as part of the pilot phase.[75]

Asked by Stephen Timms : To ask Mr Chancellor of the Exchequer, pursuant to the Answer of 11 September 2017 to Question 9026, on taxation: electronic government, what the eligibility criteria will be to establish which businesses will be entitled to free software in order to meet their income tax obligations as part of the Making Tax Digital pilot phase.

Answered by: Mel Stride : The eligibility criteria for free software under the Making Tax Digital proposals is set out in Annex C of the document covering the relationship between HMRC and software developers. The document can be found [here].[76]

The 'eligibility criteria' regarding free software for small businesses mentioned in the second of these written answers is reproduced below:

Annex C: Making Tax Digital for Businesses (MTDfB): Free software: HMRC's minimum standards and eligibility (MTDfB only)

Minimum standards

Any free software product you provide to businesses must:

- enable customers to meet the income tax and NIC obligations of a business operating using the cash basis – there is no requirement for VAT, Corporation Tax or PAYE functionality
- include free digital record keeping, free quarterly updates and free end of period statement activity
- enable the provision of a dataset that correlates to the current SA103S (self-employment supplementary page) (short) (2016-17 version)
- enable the provision of a dataset that correlates to the current SA105 UK property pages (2016-17 version) where the number of properties does not exceed one
- provide help and support in line with your new or existing entry level product (for example, webchat, email support between 9am and 5pm)
- include relevant built-in prompts and nudges as provided by HMRC in the Developer Hub
- allow the end user to own and have access to all their records created using the software product (past and present) to enable them to retrieve data and promptly export it if necessary
- be free for the business to use to comply with their MTDfB obligations for a full annual accounting period on the understanding the business continues to meet the qualifying criteria below

Eligibility for free software will apply where the business meets all these conditions:

- they're unincorporated (for example self-employed persons or landlords)
- they have a turnover, within the scope of MTDfB, below the VAT threshold
- they have no employees
- they use cash basis accounting

Other Considerations

75 PQ9026, 11 September 2017
76 PQ10115, 9 October 2017

> HMRC wouldn't require free software to link or integrate with an Agent product.[77]

The importance of online tools for small businesses was also flagged in the Taylor Review of Modern Working Practices, published just before the Government's announcement of a new timetable.

In October 2016 the Prime Minister Theresa May appointed Mr Matthew Taylor (Chief Executive of the Royal Society of the Arts) to lead a review "to consider how employment practices need to change in order to keep pace with modern business models."[78] Mr Taylor published his report in July 2017, making a series of recommendations covering a variety of issues in relation to the 'gig economy'.[79] Though the review's remit did not extend to making proposals for tax changes, it argued that MTD could bring considerable benefits for the self-employed:

> Making Tax Digital (MTD) is arguably the most radical overhaul of the tax system in a generation and is a key part of the government's plans to make it easier for individuals and businesses to get their tax right – meaning the end of the annual tax return for millions. This is important because in 2016, of the 5.5m businesses in the UK, 96% employed fewer than nine people, with 4.2m (76% of all businesses) employing no one.[80] …
>
> A number of concerns were raised by self-employed people, including the capacity for smaller firms to adapt and the overall increase in regulatory burden. The majority of businesses want to get their tax right, but the most recent tax gap figures show too many businesses are finding this hard. In fact, over half (72%) of those gig economy workers we surveyed said they would welcome an online tool to support them in paying the right tax.
>
> MTD will reduce the likelihood of avoidable errors and make the process of calculating tax liabilities easier. Once rolled out, most businesses, self-employed people and landlords will be able to keep track of their tax affairs digitally, in real time and update HMRC on a quarterly basis. This is clearly a step in the right direction.
>
> We were encouraged that HMRC is already working with third party vendors to encourage development of apps and software through which small business, including the self-employed and landlords, will comply with their MTD obligations. A small number of developers even released products in time for the start of live testing in April 2017, with large players set to follow shortly. Testing has begun with small numbers and will increase to hundreds of thousands of businesses ahead of a mandatory start date (for businesses with turnover above £85,000) in April 2018.
>
> However, millions of self-employed individuals operating in the gig economy and other parts of the economy will have turnover of less than £10k a year. For many, this will be a second job, building on income earned in another role. For others (for instance, students and carers) this may represent a small additional income and not the main source of earnings in the household. In either case, individuals in this group should still be undertaking a self-assessment each year and, even where there is no income tax liability, there may be NICs due.
>
> **Government should continue to work with providers to ensure that self-employed people have access to online tools that support compliance**

77 HMRC, *Terms of Collaboration between HM Revenue and Customs and software developers*, 19 July 2017
78 Details on the Review are on Gov.uk.
79 The Review is discussed in detail in, *Employment status*, Commons Briefing paper CBP8045, 20 July 2017 (see section 7).
80 *Solving the under-saving problem among the self-employed – An analysis by Aviva and Royal London*, June 2017

> **with the principles of MTD even if they do not meet the minimum statutory threshold.**[81]

Initially the Government anticipated giving a formal response to the Taylor review by the end of the year, but in the event this was published on 7 February 2018. On this specific question, the Government made the following comments:

> We are committed to ensuring that as many businesses, landlords, and self-employed people as possible can benefit from a streamlined digital tax system. In response to feedback about the scale and pace of change, we announced in July 2017 that these changes would be phased in with over three million small businesses joining Making Tax Digital over a longer period. We are confident that many businesses will recognise the benefits of the new system and join voluntarily. The government is working closely with software providers to ensure that there is a wide range of products suitable for businesses of different sizes. A controlled pilot is underway for income Tax; the VAT pilot will begin soon.[82]

2.6 Finance Bill 2017-19

The Government's second Finance Bill was published on 6 September, including these provisions.[83] HMRC also published draft secondary and tertiary legislation for the new regime for consultation.[84]

Prior to the formal presentation of the Finance Bill, the House has to agree a series of 'Ways and Means' Resolutions, relating to the measures that will be in the Bill. Normally this occurs at the end of the Budget debates that the House has after the Budget statement – as happened on 14 March 2017. As the Government's second Finance Bill was a new one, the House approved a second series of resolutions on 6 September, and during this debate the Chair of the Treasury Select Committee Nicky Morgan raised the issue of digital tax returns:

> No one I have spoken to objects in principle to the idea of digital interaction with HMRC over tax, but widespread concerns were raised about the speed with which Making Tax Digital was being implemented and the fact that it would be mandatory for even the smallest businesses … I welcome the deferral that the Financial Secretary announced on 13 July. It means that digital record-keeping and reporting for income tax and national insurance will not become mandatory until at least 2020 … His statement confirmed that the process will start with VAT in 2019. Most businesses already file their VAT returns quarterly and online, so it is sensible to start with a tax for which Making Tax Digital will not require such a significant change in businesses' practice.
>
> Deferring the change for some taxes for a couple of years or more will give everybody welcome time to prepare, but it will not solve all the problems. I therefore suspect that the new Committee will want to explore the costs and benefits fully, as its predecessor had started to do. There is definitely scope to scrutinise the Government's published estimates for the administrative costs to business and for the supposed reduction in the tax gap as a consequence of businesses making fewer mistakes because they are reporting digitally and quarterly. But that, you will be pleased to hear, Madam Deputy Speaker, is for another day.[85]

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81 *Good work: the Taylor Review of Modern Working Practices*, July 2017 pp79-80
82 HM Government, Good Work A response to the Taylor Review of Modern Working Practices, February 2018 p63
83 specifically clauses 60-62 of the Finance Bill 2017-19. For details see, *Finance Bill 2017 - Explanatory Notes* (Bill 102 – EN), September 2017 pp278-295
84 HMRC, *Making Tax Digital reforms affecting businesses*, 13 September 2017
85 HC Deb 6 September 2017 cc208-210

The *Finance Bill 2017-19* received a Second Reading on 12 September, and on this occasion Treasury Minister Mel Stride set out the Government's position…

> This Bill introduces significant changes to the clauses in one area that the Government intended to legislate for before the general election. Many businesses of all types and sizes have already gone digital. They do their banking online, pay their bills online, market their products and services online, and buy what they need online. Making tax digital is the natural next step. It will not only make tax administration more convenient for our businesses, but it will reap rewards for the Exchequer. Avoidable tax errors under the current system cost us almost £9 billion in 2014-15. That is more than double the cost of running HMRC and the Treasury combined.
>
> Many Members, including members of the Treasury Committee, as well as business owners, agents and stakeholder groups have had concerns about whether all businesses would be ready for this development. Well, we listened to that feedback, and one of my early decisions as Financial Secretary was to amend the timetable for delivering Making Tax Digital. Digital record keeping will now only be a requirement for businesses with a turnover above the VAT threshold, and they will only have to provide updates on their VAT liabilities.[86]

… before answering questions from Members about the impact of reform on small businesses:

> **Vicky Ford** : I thank my right hon. Friend for his announcements about Making Tax Digital and for pointing out that the change will not affect the smallest of businesses. Small businesses are the backbone of our economy, and does he agree that we on the Government Benches put small businesses first?
>
> **Mel Stride** : My hon. Friend is entirely right. We do put small businesses first, which is precisely why we listened so carefully to the feedback we received on our proposals and have made changes that will allow breathing space for businesses to prepare and for us to pilot further the plans we will introduce in due course. As the vast majority of businesses already submit VAT returns on a quarterly basis, the transition to quarterly updates through Making Tax Digital should not be unduly onerous.
>
> **Ruth George** : Although the delay in Making Tax Digital gives breathing space for very small firms, those firms will now face additional administrative requirements, possibly alongside Brexit and a dip in the economy. Is that not an added concern for businesses now that they have seen how onerous the proposals actually are?
>
> **Mel Stride** : The hon. Lady may be aware that in the consultation we received the message from businesses that they broadly welcome these changes as we move into the digital age and do things more efficiently and effectively. However, businesses did have concerns, to which we have listened, about the timing and pace of the changes we originally proposed. The policy is robust, but the Government and I are determined to get the changes right and to make them at the right pace that suits those companies.[87]

These provisions were debated, and agreed without amendment, on division, at the Committee stage of the Bill.[88]

Speaking for the SNP on this occasion Kirsty Blackman raised concerns about the impact of MTD for taxpayers with limited experience and/or limited access to the internet, but underlined that "we were clear in the SNP manifesto that we supported a phased move to digital reporting, so what the Minister has proposed is now much

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86 HC Deb 12 September 2017 cc674-5
87 *op.cit.* c675
88 Public Bill Committee, Fifth Sitting, 24 October 2017 cc120-139

more in line with what we were thinking."[89] Speaking for the Labour Party Peter Dowd stated that "[the Opposition] fully support digitalised tax reporting, which we can all agree has the potential to drastically reduce the amount of time individuals and business owners will have to spend filling out long and complicated tax returns", but disagreed that digital returns should be mandatory:

> Our greatest difference with the Government on digital reporting is the defined need for quarterly reporting. In our manifesto, we made it clear that we would permanently exempt small businesses that were below the VAT threshold from quarterly reporting. We recognise the huge administrative burden that quarterly reporting would place on them, as well as the added cost. While quarterly reporting may benefit some types of businesses—no one suggests it would not—overall, it is unnecessary and we see no reason why it should be mandatory That is why amendment 36 would ensure that it remains optional.[90]

The Opposition also tabled amendments to delay the implementation of MTD until 2022.

In response Treasury Minister Mel Stride summarised the clauses in the Bill, before opposing the Opposition's amendments:

> Clause 60 provides the framework for a future extension of making tax digital to income tax and class 4 national insurance. It sets out to whom the rules would apply—broadly, any unincorporated trading business or landlord with turnover of more than £10,000 a year. Clause 60 provides that the regulations made using these powers cannot mandate the provision of information more frequently than once a quarter, so we can be very clear on the frequency issue in the legislation. That output will be generated automatically by software and sent at the press of a button to HMRC. There will be no requirement for businesses to pay income tax or national insurance alongside their final year update.
>
> Clause 61 introduces schedule 14, which makes consequential amendments to the existing income tax administration rules. Clause 62 amends the powers in the VAT Act 1994, enabling HMRC to amend the existing VAT regulations to provide for digital record keeping and information reporting.
>
> The hon. Member for Bootle has suggested a number of amendments to clauses 60 to 62 …. Amendments 33 to 35 would have the effect of delaying making tax digital implementation until 2022 at the earliest … [The Government's new timetable] was widely welcomed … it seems a realistic path to implementation. Trade representative bodies and other stakeholders who previously expressed concerns are now engaging with HMRC to ensure a successful roll-out of the programme. HMRC has already started piloting the changes for income tax, allowing for at least three years of testing on a voluntary basis before mandation. Changing the timetable further would create uncertainty for businesses and undermine our ability to pilot the changes properly. …
>
> The hon. Member for Bootle also tabled an amendment to stipulate that there should be no requirement under MTD for mandatory quarterly updates for VAT. Under our current plans for MTD for VAT, no business will be required to provide updates to HMRC more frequently than they do now. Most already submit VAT returns quarterly and they will provide the same information with the same frequency. The difference is that the updates will be sent to HMRC from digital records.[91]

The Minister also brought up Ms Blackman's concerns about digital exclusion, underlining that HMRC would be able to craft exceptions from mandation:

89 *op.cit.* c124
90 *op.cit.* c129, c130
91 *op.cit.* cc131-2

> I recognise [the concerns of the hon. Member for Aberdeen North] … but the Government have been clear from the outset that businesses that are unable to go digital will not be required to do so …
>
> It is worth looking at some of the detail of the Bill at this point. … Clause 60 covers exemptions, as I am sure she is aware. New sub-paragraph (4) of paragraph 14 of schedule A1 states:"The digital exclusion condition is met"- for those who would not be required to put in their returns digitally - "in relation to a person or partner if…for any reason (including age, disability or location)" … "it is not reasonably practicable" - that is not the same as completely impossible - "for the person or partner to use electronic communications or to keep electronic records". I think that is a well-crafted clause to catch the kind of circumstances about which the hon. Lady and I are concerned …
>
> The clause continues with "Further exemptions". Proposed new paragraph 15(1) states:"The Commissioners may by regulations make provision for further exemptions." New paragraph 15(1) states: "The exemptions for which provision may be made include exemptions based on income or other financial criteria."
>
> There is therefore a recognition in the Bill that not only do we need to get it right for the current circumstances, but we need the flexibility to be ready for any circumstances that might present themselves and which we have not considered at this stage. Those would need to be addressed further down the line.
>
> For those who can go digital but require additional assistance, HMRC will continue to provide a diverse range of digital support, including webinars, helplines and YouTube videos, to help them meet the requirements of Making Tax Digital. [92]

Subsequently at the time of the Autumn 2017 Budget HMRC published an updated impact assessment, which put the Exchequer cost of the new timetable at around £1.4 billion over 2019-2023.[93] HMRC now estimate that MTD will raise about £1 billion for the Exchequer by 2022/23:

> **Exchequer impacts**
>
> HMRC estimates that the behavioural impacts of Making Tax Digital will contribute over £1bn to the Exchequer by 2022 to 2023. The methodology used to generate the estimates was certified by the Office for Budget Responsibility (OBR) at Autumn Budget 2017 ...
>
> The July 2017 announcement necessitated a widespread review of impacts and assumptions. HMRC's previous assessment had been based on the unincorporated business population above a £10,000 turnover threshold, circa 3.5m businesses, whereas the revised mandated population numbers circa 1.2m businesses, both unincorporated and incorporated ...
>
> **Cost summary**
>
> HMRC's revised assessment of impacts suggests that there will be an ongoing net cost to VAT registered businesses with a turnover above the VAT threshold of £37m.
>
> As previously, the government recognises that this produces a broad estimate, and so we will review and test this analysis and our assumptions through ongoing extensive engagement and consultation with businesses, and through further research and analysis. This means that the final estimate of the savings and costs to business could be different from the estimate presented here.
>
> The assessment of the Making Tax Digital impacts over the 5 year period to 2022 to 2023 is set out below. Note that the presented figures have been individually rounded to the nearest million and therefore may not sum to the net impact.

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92 *op.cit.* cc134-5

93 *Autumn Budget 2017*, HC587, November 2017 p30, Table 2.1 – item 67. Annual estimates for the period 2019/20 to 2022/23 are: £65m, £245m, £515m, and £585m.

Current breakdown of Administrative Burden impacts (all £m)

Profile (£m)	2018 to 2019	2019 to 2020	2020 to 2021	2021 to 2022	2022 to 2023
Steady-state (on-going) costs	£2	£46	£52	£52	£52
Administrative burden (on-going) savings	£0	(£8)	(£16)	(£16)	(£16)
Transitional (one-off) costs	£4	£111	£16	£0	£0
Net impact	£5	£149	£52	£37	£37

The TIIN published at Spring Budget 2017 indicated that Civil Society organisations may potentially see an increase in requests for help and support from less digitally engaged individuals and business in transitioning to the new requirements. The change in the scope of mandation may lessen that impact. HMRC is, however, continuing to work with Civil Society stakeholders to support the successful implementation of Making Tax Digital and the move to digital for both the organisations themselves and the people they represent.[94]

94 HMRC, Making Tax Digital For Business – tax information & impact note, December 2017. See also, PQ127329, 26 February 2018.

3. Annex: Treasury Committee correspondence on MTD

Following the publication of Making Tax Digital in December 2015, the Treasury Committee raised a series of queries about the implications of digital tax returns in letters to Ministers during the development of the Government's proposals.

A selection of this correspondence is reproduced below; it is also available on the Committee's site.

Letter from Chairman of the Treasury Committee to the Financial Secretary re quarterly 'tax returns', 8 January 2016

Letter from David Gauke MP to Chairman of the Treasury Committee on Making Tax Digital, 12 January 2016

Letter from Chairman of the Treasury Committee to David Gauke MP on Making Tax Digital, 25 January 2016

Letter from David Gauke MP to the Chairman of the Treasury Committee re Making Tax Digital, 1 February 2016

Letter from Chairman of the Treasury Committee to the Financial Secretary re Making Tax Digital, 26 April 2016

Letter from David Gauke MP to the Chairman of the Treasury Committee re Making Tax Digital, 10 May 2016

Letter from Chairman of the Treasury Committee to the Chancellor of the Exchequer re Making Tax Digital, 18 September 2016

Letter from the Chair of the Treasury Committee to the Chancellor of the Exchequer re Making Tax Digital, 27 October 2016

Letter from Philip Hammond MP, Chancellor of the Exchequer, regarding Making Tax Digital, 9 November 2016

Letter from Ms Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital 18 November 2016

Letter from the Chair of the Treasury Committee to Ms Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital, 29 November 2016

Letter from Ms Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital, 31 January 2017

Letter from the Chair of the Treasury Committee to Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital, 7 February 2017

Letter from the National Chairman of the Federation of Small Businesses (FSB), 8 February 2017

Letter from Ms Jane Ellison MP, Financial Secretary to the Treasury regarding Making Tax Digital for Business attached with, Updated HMRC Impact Assessment on Making Tax Digital for Business, 21 March 2017

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Letter from Chairman of the Treasury Committee to the Financial Secretary re quarterly 'tax returns', 8 January 2016

Dear Mr Gauke

Making tax digital (quarterly 'tax returns')

We have spoken informally about this and, as you know, the Treasury Committee has been seeking more information on it since the concerns about "quarterly tax returns" first gathered pace after the Autumn Statement, which took further the announcement on digital tax accounts at the March 2015 Budget.

Many small businesses, and their tax advisers, are deeply concerned about these proposals. This is scarcely surprising given the lack of detailed explanation, readily available from the Government, about how the proposals will be implemented. As the available material makes clear, implementation will take place between 2018 and 2020.

The only substantive outline of the proposal so far available describes it as "efficient and easier for businesses". With that, and the concerns expressed about it, in mind, and as a first step, I would be grateful if you would provide an assurance that:

- businesses will not be compelled to pay tax sooner than currently;
- businesses will not be required to provide quarterly updates requiring more burdensome record keeping than currently;
- adequate arrangements will be made for those businesses who do not use computers; and
- all the details, including the associated penalty regime, will be subject to full consultation prior to any decisions.

I will be placing this letter, and your reply in due course, in the public domain.

Yours sincerely

Rt Hon Andrew Tyrie, Chairman of the Treasury Committee

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Letter from David Gauke MP to the Chairman of the Treasury Committee on Making Tax Digital, 12 January 2016

Dear Andrew

Making Tax Digital

Thank you for your letter of 8 January setting out your concerns about Making Tax Digital.

Making Tax Digital is part of a bold and ambitious plan to turn HMRC into one of the most digitally advanced tax administrations in the world, which I believe will bring huge benefits for business and for all taxpayers. Under the new system businesses will find it easier to understand how their tax position is developing over the year helping them to budget accordingly. They will be able to view and manage the following taxes in this way: income tax, NICs, capital gains tax, corporation tax and VAT.

Keeping records digitally will also mean less time worrying about filling in tax returns-whether that is the taxpayer or their agent, freeing them up to do higher value work. Greater visibility of the tax position in year will also address one of the causes of business failure, when a new business gets its first tax bill, often more than a year after starting up. So businesses will have much greater certainty about their tax position and confidence about where they stand.

Making Tax Digital will mean, by 2020, most businesses, self-employed people and landlords will be required to keep track of their tax affairs digitally, using tools such as software or apps, to keep records of their income and expenditure. Many businesses already keep their records in this way. This software will connect securely to their digital tax account. Those in scope will be required to update HMRC at least quarterly via their digital tax account. This will be a light touch process, not the equivalent of making four tax returns each year. These measures will not apply to individuals in employment or pensioners, unless they have secondary incomes of more than £10,000 per year from self-employment or property.

Turning to your specific points, Making Tax Digital provides an opportunity to consider how HMRC can simplify payment arrangements for taxpayers. Many small businesses have told us that they would like the flexibility to pay more frequently if they wish, in order to smooth their cash flow over the year. But we recognise that there would be challenges for some existing businesses from paying their tax sooner, if they had to. That is why we have launched a consultation on options to simplify the payment of taxes, align payment arrangements and bring payment dates closer to the time of the activity or transactions generating the tax liability. HMRC will be running a series of consultation events in the next couple of months to discuss these payment issues with stakeholders. No decision has yet been taken.

You also asked for assurances that quarterly updating will not lead to more burdensome record keeping for businesses. Those businesses keeping paper records will need to switch to using digital tools - for example an app on a smartphone, to record their income and expenditure. HMRC will work with businesses and their representatives to make sure that help and support is available to make this change.

As mentioned above, Making Tax Digital will not mean businesses will have to do four tax returns a year instead of just one. Quarterly updates will not involve all the complexity of a full tax return, where the taxpayer (or their agent) has to gather together and then manually input data onto an electronic or paper form, once a year. Instead the updates will be generated from the digital business records, with the data gathered electronically by the software and transmitted securely to HMRC. In most cases, little or no further entry of information will be needed. It will be much quicker to do the quarterly updates than to complete the current tax return.

The operation of more frequent updating of information by businesses to HMRC using digital tools will be the subject of a public consultation to be launched in the spring. Our vision is that the updating will be as automated as possible. 30,000 small businesses are already using HMRC's free record keeping Apps. It is a small step to create a function to share this information quarterly with HMRC at the click of a button avoiding the need to enter any figures manually providing automatic calculation and avoiding errors.

You also asked for assurances that arrangements will be made for those businesses who do not use computers. These reforms are going with the grain of the way small businesses are already moving. Millions of businesses already manage their tax digitally with 98% of Corporation Tax returns and 99% of VAT returns submitted online. The benefits of digitalisation are readily accepted by the majority of small and medium sized organisations - they are already accustomed to transacting online with c2m of 5.2m small businesses currently reporting using software. 98% of SMEs use the internet with around two thirds using a smart phone.

There is also a strong and growing appetite for HMRC's digital services for businesses, with around 2.4m using the digital tax account, and over 700,000 small business customers helped across our digital assistance channels in 2014/15. Some small businesses may be reluctant to use digital channels for tax (the overwhelming majority are already using digital channels for non-tax purposes). HMRC will provide guidance and support to help these businesses make the switch to digital. They will also have options to use trusted others to help them, such as family members or the voluntary and community sector. For those genuinely unable to adopt digital tools due to geography, personal disability or other circumstances other channels, such as telephone filing, will remain available. HMRC will consult on how to define this group and the services they will need.

Finally you asked for assurances that all the details, including the associated penalty regime, will be subject to full consultation prior to any decisions. As you can see above we are consulting extensively on the details of Making Tax Digital and the penalty regime is no different. We will consult during 2016 on what sanctions might be appropriate for a more digital tax administration.

But I want to make clear that the in-year updates will not be subject to the same sanctions for lateness or inaccuracies as apply now to the year-end position. The Government recognises the importance of engaging with stakeholders in the development of tax policy and takes its commitments to do so seriously. Our ambition to end the tax return was first announced back in March 2015, three years before the first changes are due to come into effect.

Making Tax Digital is not about making people do four tax returns nor four sets of accounts a year; it is about bringing the tax system into the digital age, saving businesses time and money in the long run and giving them more control of their tax affairs. Complex and off-putting year-end returns will become a thing of the past. And it will unlock a number of other improvements, including the capability increasingly to tailor HMRC's communications with businesses, for example, about reliefs and allowances, and how they can make best use of them.

We are introducing these reforms gradually and, as I have set out above, will be consulting on the details of the proposals throughout 2016. We will use volunteers to test the new tools and processes and give us feedback. Quarterly updates will be introduced for some from 2018, and will be phased in fully by 2020, giving taxpayers time to adapt. I do not underestimate the scale of the change that Making Tax Digital represents - in particular as we make the transition to the new arrangements.

I am confident that by working closely with businesses and their representatives HMRC will deliver this change in a way that works well for all parties. I hope this letter helps to address your concerns, and those of the Treasury Committee, about Making Tax Digital and I look forward to discussing this with you further.

If you would find it helpful, my officials would be happy to provide a briefing session for you and the rest of the Treasury Committee on Making Tax Digital.

Yours ever, David

David Gauke MP

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Letter from Chairman of the Treasury Committee to David Gauke MP on Making Tax Digital, 25 January 2016

Dear David

Making Tax Digital

Thank you for your letter to all colleagues of 11 January and your fuller letter to me of 12 January. In my letter of 8 January I sought assurance on four points.

Your letters provide a degree of assurance on my first, third and fourth points - although they were silent on those businesses who do not currently use computers but who do not fall within the category of being "genuinely unable to adopt digital tools". While the software and the apps may be free, it would be unacceptable if they had to purchase hardware solely to meet their tax obligations. I am glad that you are planning to consult on this before making decisions.

Your letters have not provided me with any assurance on the second point in my letter. It is plausible to suppose that some small businesses' current record keeping practices are less burdensome for them than keeping their business records digitally and updating them at least quarterly. I would be grateful if you could address this point. It is hard to see how the plans will reduce the administrative cost to businesses by £400 million, as the Chancellor suggested on the floor of the House last Tuesday. It would be extremely surprising if such a huge aggregate saving, worth a lot to the individual businesses involved, had been overlooked by them. It would also be surprising if those who the Government feel would benefit from changes to their record keeping had not spotted some of those gains.

I would also welcome some clarification of the revenue benefits. Your letter states that only 10 per cent of the benefits would be achieved if the quarterly updates were optional. What are the assumptions behind this calculation, and of the overall revenue benefits? Taxpayers and their agents remain deeply concerned about the proposal to make digital tax accounts and quarterly updates mandatory for all businesses. They understandably will need more information on the practical application of the proposals than has hitherto been provided if these proposals are to achieve widespread acceptance.

I will be circulating this letter to all MPs and placing it, and your reply in due course, in the public domain.

Yours ever, Andrew

Rt Hon Andrew Tyrie, Chairman of the Treasury Committee

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Letter from David Gauke MP to the Chairman of the Treasury Committee re Making Tax Digital, 1 February 2016

Dear Andrew

Making Tax Digital

Thank you for your further letter of 25 January about Making Tax Digital. I'm glad my previous reply provided you with assurances on the majority of your questions. I have sought to address your outstanding concerns below.

Firstly, on your point about those without access to their own computer, on the scale of the potential issue, our research suggests that around 98% of SMEs already use the internet. I want to reiterate there is no question of forcing those who cannot go digital to do so. Help will be available for businesses who struggle to use digital tools and alternatives, such as nominating an agent or friend, as well as giving information by phone will be available. As you say in your letter, we will be consulting in the spring on the exact scope of Making Tax Digital, including considering very carefully our approach to the minority without computers or smartphones.

In addition, whilst not the driver for the proposed reforms, but as raised by colleagues at the recent Westminster Hall debate, we must not forget the wider benefits on productivity and growth of encouraging more businesses to go online and use digital tools, including providing greater access to both domestic and overseas sales markets.

You also asked that I readdress your question about additional burdens. You supposed that some businesses' current record keeping practices might be less burdensome for them than switching to digital. While a switch to digital may involve a transitional 'cost', I am confident that the overall benefits, in terms of ease, simplicity, speed and certainty of outcome will outweigh any initial cost. For example, a business may keep a perfect set of manual books, but in compiling their tax return will need to manually transpose their records either into their tax return, their VAT return or both - or pay their accountant to do so. Under Making Tax Digital the software would make this manual activity automatic, saving the business time and money, freeing up time to grow the business.

The technology to do this is already available and up to 2m businesses are already using it. There is a range of products which, for example, allow physical records (such as receipts) to be scanned using mobile devices, automatically included into record keeping software and stored (removing the need to keep paper receipts in many cases). Indeed this is a growing marketplace -you might have seen recent TV adverts for digital products where a small business can run their affairs from their smartphone or tablet, with links to their sales, their expenses, and their business bank account. In fact all they need to stay in control; the software even produces accounts.

Our MTD proposals would see tax integrated into these packages, saving the business from having to do it as a separate activity with associated costs. The software industry are keen to work with HMRC to do this - including making available free apps for those with the most straightforward affairs. So, for businesses already using software, the integration of tax will deliver benefits quickly.

Of course there is a lot to work through and I don't underestimate the scale of change that some businesses will need to make. I understand that for some that the transition will be challenging and HMRC will make sure that help and support is available to make this change. I'm confident through consultation that is underway now, and is planned throughout 2016, we can find a way forward that will smooth the transition for all businesses.

The proposed changes will contribute to HMRC's target to reduce business burdens by £400m. I set out in the Westminster Hall debate on Monday that, as with any other tax measure, a detailed assessment of the impact on administrative burdens will be published alongside draft legislation, and that is expected to be in December 2016. HMRC anticipates producing an initial draft impact assessment alongside the formal consultation process, which starts in the spring.

The revenue benefit of Making Tax Digital comes from a reduction in error as a result of more timely and accurate record-keeping using software, and the requirement to update HMRC quarterly. Some £6.5bn is lost each year as a result of errors made by businesses, and I make no apology for seeking to tackle that.

Under a voluntary approach those taxpayers who most need to raise the standard of their record-keeping are least likely to do so, and the revenue benefits from the proposals would therefore significantly reduce.

I appreciate the time businesses and agents have taken to share with me and HMRC their concerns and I hope through avenues such as our correspondence and the debate on Monday we are starting to dispel some of the myths about Making Tax Digital. These reforms are being introduced gradually and we will be consulting extensively with businesses and their agents throughout 2016 to ensure their concerns are taking into account and addressed. Once again, thank you for writing and I hope this addresses your remaining concerns.

Yours ever, David

David Gauke MP

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Letter from Chairman of Treasury Committee to the Financial Secretary re Making Tax Digital, 26 April 2016

Dear David

Making Tax Digital

I understand that HMRC has recently clarified, for the first time, that businesses would be required not just to submit information to HMRC online once a quarter, but that they would also be required to do all their record keeping in a prescribed digital format.[95]

This would entail the use of designated software packages. It would have an impact on large businesses (who may not currently have accounting systems which are compatible with HMRC's requirements) as much as on small businesses (who may not use computers).

For several months HMRC have been talking of keeping business records "in digital form". Until last month there was a general understanding among most tax professionals that businesses could use their own choice of package for their record keeping, as long as it was digital. Digital had not been clearly prescribed and was understood to include, for example, Excel. It was only recently that HMRC's apparent intended meaning - that businesses will be required to use particular software, and systems that are compatible with HMRC's - has become clear.

This may affect the overwhelming majority of businesses. A survey published by the ICAEW recently suggested that 75 per cent of all businesses, and 82 per cent of sole traders, would need to change their record keeping systems to comply with the Government's new proposals for Making Tax Digital.[96]

If this sample is representative, and if their fears are borne out, then it seems implausible that Making Tax Digital could generate large savings to business - as the Government is forecasting. On the contrary, the vast majority of businesses may face increased compliance costs. This would be a cause for serious concern.

It is not too late to do something about this. A thorough impact assessment is the minimum required before proceeding with the Government's proposals to make digital record keeping compulsory.

I will be placing this letter, and your reply in due course, in the public domain.

Yours ever, Andrew

Rt Hon Andrew Tyrie, Chairman of the Treasury Committee

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95 *Digital Record Keeping*, Tax Faculty Team, ICAEW, 4 March 2016
96 *UK business survey into quarterly digital tax reporting*, Tax Faculty Team, ICAEW, 11 March 2016

Letter from David Gauke MP to the Chairman of the Treasury Committee re Making Tax Digital, 10 May 2016

Dear Andrew

Making Tax Digital

Thank you for your further letter of 26 April regarding some aspects of Making Tax Digital.

Firstly, I welcome your recent statement where you acknowledged that there is "no doubt Making Tax Digital is the future". The government is committed to reducing burdens for taxpayers and building a transparent and accessible tax system fit for the digital age.

The tax system has not kept up with the technological advances of the digital age. Currently, we make taxpayers review 18-month old records, stored in a variety of formats, none of which can interact with HM Revenue and Customs (HMRC) systems. Either they complete a lengthy HMRC form, re-entering data recorded elsewhere or they go to their accountants and drop off a carrier bag of records, getting them to complete their return on their behalf. When they pay their final tax bill, it is on money made up to 21 months previously. Clearly it is an outdated system designed for a world of paper and not fit for the 21st century.

Compare that to how businesses are harnessing the opportunities of digital technology and fundamentally transforming their operations and the services they provide so that their customers reap the benefits.

Making Tax Digital will deliver greater control, certainty, and confidence to businesses. The software will do much of the work to provide HMRC with the required information for the quarterly updates, so submitting an update will feel very light touch. It will also provide nudges and prompts that flag up reliefs or allowances to which businesses may be entitled, and offer access to built-in help to enable businesses to get their tax affairs right. We have already started testing our proposals with businesses and they have been generally positive about the Making Tax Digital software, saying that it appears simple to use and much easier to submit tax information than the current system.

You asked specifically if HMRC had recently revealed new information about Making Tax Digital. This is not the case. The government has been clear since the first announcement at Autumn Statement (AS) 2015 that the reforms would involve both digital record keeping and quarterly updates. Indeed the Making Tax Digital Roadmap (published in December 2015) sets this out - *"Businesses will use software that compiles their tax data as part of their ordinary day-to-day activity, highlighting any possible errors . . .. offering prompts for information that might otherwise be overlooked. Once the software has compiled the relevant data, businesses or their agents will feed it directly into HMRC systems"*

Since December, both HMRC and I have had a number of discussions with business representatives. In January, I also set out to colleagues in a Westminster Hall debate that *"updates will be generated from digital records. It will be much quicker, easier and far Jess burdensome than the current process. The agony of the annual tax return will be a thing of the pasf'*. In my letter to you of 12 January, I was also explicit that *"businesses keeping paper records will need to switch to digital tools, for example an app on a smartphone, to record their income and expenditure."*

Regarding your question on the format, last September HMRC published its *Third Party Software and Application Programming Interface (API) strategy*. The aim of this strategy is to deliver the widest range of compatible and secure software products and enable providers to bring more sophisticated products to the market whilst ensuring their compatibility with HMRC systems. We are already seeing this strategy deliver new and innovative products. For those businesses already using record keeping software (including those you have highlighted), we are exploring to what extent anything new will be necessary or whether existing software packages will be sufficient with the aim of minimal disruption.

With regards to your request for a full impact assessment to be published, I can confirm HMRC will publish an initial assessment of the impacts of the new requirements for businesses alongside an overview of the potential costs and savings for businesses as part of the planned consultations this year. This will include the contribution these reforms will make towards the £400m administrative burdens reduction target for business.

There will be an opportunity for interested parties to consider the initial assumptions behind the impact assessment when it is published, and the detail of the proposals when the formal consultation begins. We will be working extensively with stakeholders throughout 2016 to develop our evidence which will inform the updated assessment in the Tax Information and Impact Note to be published alongside draft legislation.

I recognise that these proposals will require a behaviour shift for many smaller businesses, but it is important to note that they go with the grain of what millions of businesses are already accustomed to doing - transacting online, including with the taxman. Research by the Department for Business Innovation and Skills in 2015 found that 97% of small businesses and 92% of micro businesses had access to the internet at work. It is therefore unsurprising that the overwhelming majority of returns for the main business taxes are submitted online.

Some two million small and medium sized business are already using software for payroll and VAT. In the last year the number of users accessing their digital tax account has more than doubled to over 5 million. Businesses therefore have a strong appetite for digital services, as do the agents who represent them. An overwhelming number of businesses already choose to maintain their records in a digital format even though there is currently no requirement for them to do so.

We continue to listen closely to businesses and their representatives to make the transition as smooth as possible. HMRC will ensure that compatible software products are available to suit the budgets and needs of all businesses, including some free products for those small businesses with the simplest affairs.

Of those businesses not currently using software, HMRC will provide additional support to build their confidence in using digital tools for their business, simplifying their affairs and integrating tax into their ordinary day to day activity. Last year, over a million businesses accessed HMRC's digital help and support services.

I am therefore confident that the tools will be there to support small businesses to make the change. I am aware that while most stakeholder groups have welcomed the vision of a transformed and fully digital tax system, concerns about its implementation still remain. This is why I have asked HMRC to listen to stakeholders who represent small businesses and their intermediaries ensuring that the final design takes account of their views and is fully informed by existing practices. We will be consulting widely on all aspects of the planned changes and I hope businesses will engage in this consultation.

I hope this letter addresses your concerns, and those of the Treasury Select Committee. By consulting and engaging with interested parties, together we can get these reforms right and ensure that Making Tax Digital delivers on the promise of a tax system fit for the 21st century.

Yours ever, David

David Gauke MP

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Letter from Chairman of the Treasury Committee to the Chancellor of the Exchequer re Making Tax Digital, 18 September 2016

Dear Chancellor

Remit for HM Revenue & Customs 2016-17: Making Tax Digital

Thank you for sending me a copy of your letter of 31 August to Jon Thompson and Edward Troup. Among other things, you are asking HMRC to deliver Making Tax Digital (MTD) and to bring forward legislation for Finance Bill 2017.

The immediate reaction from many commentators in August had been one of relief at the fact that the much-trailed consultation papers on MTD had finally been issued and that there were some concessions from the Government. Last week, the Treasury Committee heard initial evidence from businesses, expressing a good deal of concern about MTD. More may emerge over the coming weeks, as businesses digest the huge amount of detail in the consultation papers.

Some of the issues already put to the Committee in that evidence, or to me, include:

- At first sight, it was a relief to read that many businesses already transact with HMRC digitally for VAT and corporation tax. However, the detail makes clear that the new requirement for digital record keeping and reporting is far more than simply entering a handful of totals (which could come easily from paper or an Excel spreadsheet) into an online VAT return. It is tantamount to prescription by HMRC, for the first time, of a particular form in which accounting records must be maintained.
- The proposal for free digital tools for the smallest businesses with the simplest affairs was welcome. But views can only be formed when there is more information on what will be available, to whom or for what type or level of income and for how long its free availability can be assured. The software industry, the government and the small business sector will have different, and competing, objectives in defining this.
- The consultation papers do not make clear how the quarterly updates will align with Universal Credit monthly updates, which will also be needed from the low paid.
- There will be an exemption for people whose income is less than £10,000. But this is below the level of the Personal Allowance. So it appears that this concession will only be for those who do not pay tax, including new businesses who would otherwise be obliged by MTD to notify HMRC within four months of starting a business. In such cases, there would be no benefit, to the businesses or to HMRC, if they were to submit quarterly reports.
- Those businesses with a turnover of just over £10,000 (and with profits of far less than £10,000) will be hardest hit if they are obliged to change their working practices; those who currently employ a book-keeper once a year to prepare their tax return might find themselves having to employ the book-keeper four times a year. This could be very burdensome.

The Treasury and HMRC will need carefully to consider all the comments that you receive. Given the length of the consultation papers and the complexity of the issues, many of those comments may well not be received much before the closing date of 7 November. Legislating in Finance Bill 2017 means that there will be little time for further development of the proposals between the end of the consultation and the normal date for the publication of draft Finance Bill clauses, around the end of November.

MTD may improve the customer experience for a growing number of people who are able to engage digitally. For example, so called 'nudges and prompts', if designed properly, could make dealing with HMRC a less intimidating experience; it could provide the facility of 'what if scenarios to give businesses certainty about the tax consequences of their decisions. Implemented carefully, it could do some good. But it could also do much harm.

The consultation is therefore crucial. It needs to be meaningful. There may be a case for delaying the implementation of MTD. A year's extension for an unspecified group of businesses may not be enough. There may also be merit in piloting the systems. From this, the lessons from customers' experiences can be learnt, and well before digital reporting is made mandatory.

HMRC's proposals are major changes. There remains considerable cause for concern with the proposals. Better to get it right than to stick to a rigid timetable.

I will be placing this letter, and your reply in due course, into the public domain.

Yours sincerely

Rt Hon Andrew Tyrie, Chairman of the Treasury Committee

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Letter from the Chairman of the Treasury Committee to the Chancellor of the Exchequer, 27 October 2016

Dear Philip

Making Tax Digital

The Committee was extremely concerned by the evidence it heard on Tuesday from accountancy representative bodies and the Federation of Small Businesses (FSB) about Making Tax Digital (MTD).

Among other things, it heard the FSB's estimate that implementing MTD will cost £2,770 per business per year on average. This is in addition to the £3,600 that they already spend on help and advice with tax compliance. For businesses above the VAT registration threshold, this is a sizeable sum. As for those below the threshold, witnesses pointed out that MTD may trigger their closure. Even worse, some may elect to continue trading in the hidden economy. Both closure and hidden economy trading would result in revenue loss. Even for those businesses which continue to trade legally, MTD will bring additional costs in both time and money, which might reduce their taxable profits. Has your estimate of the exchequer impact taken account of each of these three likely effects of MTD?

A fully costed impact assessment is essential. The Government published a Tax Information and Impact Note (TIIN) alongside the consultation papers, but this fell short in a number of respects and it provided insufficient detail to support the claimed benefits to business. A new impact assessment is needed to reflect the information that is now available.

It is essential that it reflects the specific impact on seasonal businesses, the lack of digital skills among small businesses and the impact of unreliable broadband connectivity. It is also essential that it provides detailed information on:

- the cost of software (and upskilling to use it) and hardware (for those businesses who do not currently maintain accounts electronically);
- the impact on business productivity; the cost of migrating on to new accounting systems;
- the time that businesses will need to meet the additional administrative burden and to deal with queries etc. from HMRC; and
- the cost of employing tax agents and accountants.

It is clear from the evidence that the Committee heard that HMRC needs mandatory MTD to fulfil its business case for much needed investment in its IT. But it is equally clear that businesses will have to pick up the bill for this. The measure is therefore a transfer of the cost from HMRC to businesses.

Given these points, the evidence we heard suggests that the introduction of MTD should not be rushed. Every effort should be made fully to pilot its introduction, perhaps over several years. Only after the lessons have been learned from the pilot should consideration be given to a mandatory scheme. I originally wrote to you on MTD on 15 September. I would be grateful for a prompt rely to both my letters. I will be placing this letter, and your reply in due course, into the public domain.

Yours ever, Andrew

Rt Hon Andrew Tyrie, Chairman of the Treasury Committee

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Letter from Philip Hammond MP, Chancellor of the Exchequer, regarding Making Tax Digital, 9 November 2016

Dear Andrew

Making Tax Digital

Thank you for your letters of 15 September and 27 October about Making Tax Digital (MTD). I sincerely apologise for the delay in replying to your first letter. I am very grateful for your continued engagement with HM Revenue and Customs (HMRC), HM Treasury and Ministers on this issue among others, and for the number of considered points and evidence you raise in relation to the Government's MTD proposals. I understand these are already being considered by HMRC as part of the consultation, which as you know closed on 7 November. I have asked the Financial Secretary to the Treasury to be the Minister responsible for the design and implementation of this policy, and she will be replying separately to your letters.

Freeing businesses from red tape and allowing them to thrive and flourish is a central part of the Government's economic plan and these reforms play a key role in this. We have a shared goal of ensuring the tax system is made fit for the digital age, and that the transition for businesses is as smooth as possible. Both the Financial Secretary and my officials would be willing to meet with you and the Treasury Select Committee in due course to discuss the issues you raise.

Yours ever, Philip

Philip Hammond

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Letter from Ms Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital18 November 2016

Making Tax Digital

Thank you for your letters of 15 September and 27 October and for sharing the feedback the Treasury Select Committee has received about the Government's Making Tax Digital (MTD) proposals. I do appreciate your taking the time to draw these concerns to my attention, and also the exchange of correspondence you had with my predecessor on this issue. I apologise for the delay in replying to your most recent letters.

MTD aims to deliver a tax system which keeps up with technological advances in wider society. Increasingly taxpayers expect to be able to interact with the tax system through digital channels, as they do in commercial transactions and with other service providers. In addition, MTD will make it easier for businesses to get their tax right, including, as you point out in your letter, increasing awareness of reliefs and support available to them through nudges and prompts. The latest figures for the tax gap caused by error - more than £8 billion - show the importance of doing all we can to support businesses in this regard, reducing the inconvenience and cost of HM Revenue and Customs (HMRC) interventions. Mandating the changes ensures that we secure these benefits for businesses and for the taxpayer.

As you are aware, the Government published a number of consultations on 15 August, which closed recently. The consultation period included a conference, 15 roundtable meetings, 14 webinars and other speaking events. HMRC and HM Treasury officials continue to review and consider all the responses received. I can assure you that final policy decisions will take account of all these responses and our ongoing discussions with businesses and professional bodies.

Since we spoke about MTD in the summer I have had useful meetings with the Federation of Small Businesses (FSB), the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales amongst others. I understand that the Treasury Select Committee has received evidence from a number of sources on their concerns regarding the transitional cost of the changes, including from the FSB. HMRC has not seen the assumptions underpinning the FSB's analysis, but will consider the report when it is available alongside the evidence provided through the consultation. The Government will set out a full impact assessment through the Tax Information and Impact Note, which will be published alongside the draft legislation.

However, as part of the consultation, HMRC published an initial assessment of the impact of the changes on business based on two different scenarios (with ongoing savings post transition of £85m and £250m). I am confident that this reform will deliver steady state savings to business.

As you are aware, the Government has consulted on what financial assistance is appropriate to help support businesses through the transition, and will set out its plans in due course. Clearly with a reform as important as this timing of the roll-out is key. The Government intends to implement MTD gradually over a number of years, starting with Income Tax and NICs from April 2018, before being introduced for VAT in 2019 and corporation tax in 2020. The Government's response to the consultations will provide further clarity on timings and exemptions. Nevertheless, the staggered start dates will allow time for systems to be tested and refined at the piloting stage, before being released more widely.

HMRC will be running two pilots for Income Tax Self-Assessment and is recruiting a variety of businesses, from those who file on paper to those who use agents and software. The first pilot started in October this year and will involve 1000 participants. The second pilot will begin in April 2017 with around 400,000 businesses across a wide range of trade sectors and geographical areas. There will also be pilots for both VAT and corporation tax in due course. There is no doubt these reforms are significant for all parties - businesses, agents (and others) who represent them, the software industry and HMRC.

I am grateful to all those who have contributed to the consultation; we will continue to engage widely with all stakeholders to ensure we deliver this programme of change successfully. I look forward to an ongoing dialogue with you about Making Tax Digital, and would, of course, be happy to discuss these proposals further with the Treasury Select Committee in due course. I hope this is helpful. Kind regards, Jane

Jane Ellison MP

Letter from the Chair of the Treasury Committee to Ms Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital, 29 November 2016

Dear Jane

Making Tax Digital

Thank you for your letter of 18 November.

It was little more than a holding response, pending the Government's publication of the full impact assessment. In the light of paragraph 4.43 of the Autumn Statement, I assume that this will not be before January.

That paragraph said "In January 2017, the government will publish its response to the Making Tax Digital consultations and provisions to implement the previously announced changes". Paragraph 4.3 of the Autumn Statement said that "the government remains committed to the tax policy framework and will consult on tax changes in the spring and draft legislation in the summer, before they are introduced as Finance Bills." The tax policy framework stated that "in most cases ... draft clauses for the Finance Bill will be published for scrutiny at least 3 months before the Bill is introduced to Parliament" although "there will be times when it will be necessary to deviate from this framework.

In these circumstances the Government will be as open as possible about the reasons for such deviations." This suggests either that Making Tax Digital is one of those deviations; that Finance Bill 2017 will be introduced to Parliament later than is normal; or that Making Tax Digital will be legislated in Finance Bill 2018 (which would. leave very little time, if implementation is still planned for April 2018).

I look forward to receiving your substantive response in January. I will be placing this letter, and your reply in due course, into the public domain.

Yours ever, Andrew

Rt Hon Andrew Tyrie, Chairman of the Treasury Committee

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Letter from Ms Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital, 31 January 2017

Making Tax Digital

Thank you for the Treasury Select Committee's (TSC's) recent report on Making Tax Digital (MTD) and the wider contribution you and your committee have made to the debate around how best the tax system can be administered in the digital age.

Two million small businesses already use software to keep their records, produce their accounts or administer their tax. Indeed, to date nearly 9 million (92%) have filed their Self Assessment return digitally this year, up from just over 39,000 (0.5%) when it was first introduced in 2000. Clearly then, a digital tax system goes with the grain of wider technological developments and it is important to ensure the tax system is future-proofed.

I welcome the consensus emerging from the consultations that digitalisation is the right aim, and recognise that debate remains about the best way of achieving this. I am writing to you to provide further details of the Government's response to the consultations, which was published today, alongside the draft legislation and an updated impact assessment.

These reforms remain important given the cost to the Exchequer of the tax gap. The most recent figures on the tax gap show that more than £8 billion a year is lost as a result of avoidable errors by small businesses. MTD will help the self-employed, businesses and landlords get their tax right first time. As well as the reduction in the tax gap, this will also reduce the cost, uncertainty and worry that businesses face when HM Revenue and Customs (HMRC) is forced to investigate. The response documents reflect HMRC's extensive engagement with a wide range of stakeholders, most recently via the formal consultations which closed on 7 November 2016 with over 3,000 responses received.

I am pleased that so many took the time to respond to the consultations, and I would like to take this opportunity to clarify some queries you have raised in past correspondence with Treasury Ministers.

Spreadsheets

You previously asked whether spreadsheets would be compatible with MTD software, given the number of businesses, the self-employed and landlords who are already maintaining regular digital records in this way. I can confirm that the use of spreadsheets to record receipts and expenditure will count as digital record keeping for MTD, provided the spreadsheet is able to produce and send the quarterly summary updates to HMRC and complete the end of year activity. This is likely to involve combining the spreadsheet with software. HMRC will test this process during the planned pilots.

Software

You have also previously raised the issue of free software. The Government's response confirms that free software will be available to the smallest businesses with the most straightforward affairs, largely those that are unincorporated, under the VAT threshold, and without any employees. In addition, as a minimum, it is proposed that free software would allow businesses to do everything a business needs to comply with the requirements of MTD. HMRC is working with software developers to ensure that a number of free products are available to these businesses.

Impact Assessment

The TSC's report cited estimates of the cost to businesses of MTD. An updated impact assessment informed by the responses to the consultation has been published, which includes details of the transitional costs. We recognise that there is an inevitable one-off transitional cost of the reform. However, this is far lower than those cited in the TSC's report. After the transition, the impact assessment forecasts an ongoing administrative saving to businesses year on year. We will continue to refine the impact assessment as we begin to trial MTD.

Testing and live pilots

As we have discussed before, testing is essential to the successful implementation of the changes. HMRC will run a series of pilots to support the delivery of MTD, testing the new products and services before mandation. Initial testing has already begun for those in income tax self-assessment, including some who currently keep their records on paper. A year-long 'live pilot' will begin from April, building up slowly to several hundred thousand volunteers. This will allow a full test of each stage of MTD before that stage is mandated. A wide range of self-employed businesses, landlords and agents will be involved in this live pilot, from those already using software to those keeping their records on paper. Extensive testing should ensure that by the time mandation starts, from April 2018, we can be confident that a range of software products is available at different price points (including free for the smallest businesses) and that these products are user-friendly.

Exemption and deferral

As you know, the MTD consultations also specifically explored the appropriate level of the initial exemption and deferral for the self-employed, landlords and businesses who will be in scope. Given the range of views expressed on this matter from respondents to the consultation and notably from your committee, the Government will take more time to consider these issues alongside the fiscal impacts. Final decisions will be made before legislation is laid later this year.

Next steps

The 12 week consultation ran from August to November. We will now consult on the draft legislation until the beginning of March. There has been extensive engagement already on these reforms, and I hope that will continue. I remain, of course, very happy to discuss these proposals further w ith you and the Treasury Select Committee.

As ever happy to pick up any further concerns, with kind regards, Jane

Jane Ellison MP

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Letter from the Chair of the Treasury Committee to Jane Ellison MP, Financial Secretary to the Treasury, regarding Making Tax Digital, 7 February 2017

Dear Jane

Making Tax Digital

Thank you for your letter of 31 January.

You specifically refer to the impact assessment. As you note, the Government's estimate of the transitional costs (£280 per business) is far lower than the estimate given to the Committee by the Federation of Small Businesses (£2,770 per year per business).

You have provided some detail to support your estimate. I would be grateful for any further information that you have to support that number. The impact assessment also states that the updated revenue estimate will be published in Budget 2017. The Treasury Committee will, no doubt, discuss these estimates with the Chancellor when we see him in April.

I will be placing this letter, and your response in due course, in the public domain.

Yours ever, Andrew

Rt Hon Andrew Tyrie, Chairman of the Treasury Committee

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Letter from the National Chairman of the Federation of Small Businesses (FSB), 8 February 2017

Dear Mr Tyrie,

Re: Making Tax Digital

Thank you for your letter regarding the Treasury Select Committee’s intention to explore the estimated costs of Making Tax Digital in more detail, which the Federation of Small Businesses (FSB) welcomes. I set out below the methodology behind our own estimates.

FSB members were concerned by the initial decision to not publish a detailed impact assessment of such a major change, at the time of the Autumn Statement 2015. A year later, that concern had escalated, compounded by the knowledge that an impact assessment had been carried out, but not shared with the business community, taxpayers or indeed MPs.

In response to the serious delays to the publication of this impact assessment, on behalf of our members, FSB wanted to estimate the costs that mandatory quarterly online tax reporting would impose upon small businesses. We subsequently commissioned an external economics consultancy, the Centre for Economics & Business Research (CEBR), to carry out the work to provide an independent estimate for the average potential cost to a UK small business. Their calculations were restricted by the limited amount of data HMRC had made available on Making Tax Digital at that stage. However, these were based on sensible assumptions built upon small business's existing tax administration burden. CEBR noted that the costs to business would vary considerably depending on the final shape of the scheme, such as the final turnover exemption threshold which the Government sets for quarterly tax reporting. This is of course yet another decision which has still not been taken, even now in early 2017.

CEBR first looked at the total time and money businesses spend on their current annual tax reporting. There is no data to suggest that those who currently get all their information together to complete their tax return online spend any less time than those who do the same process in paper form. At the time, the average business owner spent just over three hours on their tax reporting, and based on average wages, this cost the average business £401 over the course of a year, which works out at £100 per quarter, or £33 per month.

CEBR then looked at the cost of additional staff working on tax reporting – this could be someone already working at the company, or a specialist who is hired for the task. The average business requires over three and a half hours of additional staff time for tax reporting, on top of the time spent by the owner. Based on the pay of the additional staff, businesses spent an additional £152 per quarter on tax reporting, or £51 per month

Added together, the average cost of tax reporting was around £252 per quarter for UK businesses, or £84 per month. Over a year, a business will therefore spend £1,008 on average on tax reporting.

For the purposes of projection, CEBR estimated that businesses would spend three times as long on their tax reporting each year under Making Tax Digital. They based this multiple of three on the assumption that, although reporting will be completed four times as often, the Government's literature makes a point of the simplification of the digital process, and they estimated that this would decrease the time spent on the reporting.

Therefore, our figure of £2,770 is a scalable one subject to further information from HMRC being published. This additional time spent is scalable from the previously identified cost of annual tax reporting (£1,008).

However, these costings do not include the following:

- The additional cost of installing the system – it may take time and money to install the software;
- The potential cost of buying computers (or upgrading computers) to use the software – many small businesses report taxes with pen and paper, and these businesses would need a computer to complete the reporting;
- The ongoing costs of software and apps (including updates);
- The cost of training staff to use the software;
- The cost of IT support if the system does not work or is experiencing difficulties.

I hope this answers your questions but please do not hesitate to contact me if you would like to discuss this issue further.

Yours sincerely,

Mike Cherry AIMMM FRSA, FSB National Chairman

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Letter from Ms Jane Ellison MP, Financial Secretary to the Treasury regarding Making Tax Digital for Business, 21 March 2017

Dear Andrew

MAKING TAX DIGITAL FOR BUSINESS

Thank you for your letter of 7 February concerning Making Tax Digital for Business.

You asked for further information to support HMRC's estimate of the costs to business arising from Making Tax Digital. On 31 January, the government published an updated impact assessment, informed by consultation responses. This included HMRC's estimates of the transitional costs and an explanation of how these were made.

However, I recognise that it is in the public interest to be clear about how HMRC's estimate compares to the estimates provided by external commentators. I have therefore provided further information annexed to this letter detailing the methodology and assumptions underpinning the impact assessment.

I hope you find this explanation and the enclosed note helpful. HMRC's methodology is well established and based on current evidence. However, HMRC will, of course, continue to update its assessment in the light of any new evidence it gathers, for example, through the large scale public pilot.

I hope this is helpful, with kind regards, Jane

Jane Ellison MP

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Updated HMRC Impact Assessment on Making Tax Digital for Business, 21 March 2017

MAKING TAX DIGITAL FOR BUSINESS (MTDfB)

UPDATED IMPACT ASSESSMENT

This note covers the methodology and assumptions behind HMRC's work on the administrative burden impacts, steady-state and transitional costs of the MTDfB reforms.

HMRC used the well-established Standard Cost Model (SCM) methodology together with internal customer insight and information obtained from engagement with stakeholders to derive the MTDfB impact assessment estimates. HMRC also took account of responses to the consultation "*Bringing Business Tax into the Digital Age*", published on 15 August 2016, which included a substantial amount of narrative feedback on anticipated business impacts, largely anecdotal, with only a small number of respondents providing any financial estimates.

Methodology – Administrative burden impacts and steady-state costs

The SCM methodology was used to estimate administrative burdens impacts and steady-state costs for the MTDfB impact assessment.

The SCM represents the cost of complying with the tax system for a normally efficient business. This provides a consistently calculated and informed set of estimated costs for each tax obligation, averaged across the entire business population. The SCM is a comprehensive model for estimating administrative burdens that uses data collected externally directly from businesses. The OECD recognises the SCM as a quantitative methodology that can be applied in all countries and at different levels. Furthermore, in this area, the European Commission has recognised the UK's approach and efforts to measure customer costs as among the most advanced among EU member states.[97]

The SCM methodology:

- is based on cost estimates informed by data collected independently by KPMG from business accountants who work with small businesses and sole traders, and their own experience as a provider of tax related services and advice;
- is updated regularly by HMRC when new evidence becomes available; wage rates, postage and acquisition costs, populations and underlying assumptions have all been updated on a regular basis during the existing SCM's lifetime;
- was the subject of a large scale update in 2015, utilising both externally commissioned research and internally sourced taxpayer data;
- includes estimates of price (that is, the activities that a business has to undertake to be compliant with UK tax legislation and the cost to the business of these activities) and also quantity (that is, the numbers of businesses affected by a particular obligation or piece of legislation);
- therefore uses a consistently calculated and informed set of estimated costs for each obligation;
- contains data for the majority of HMRC business obligations; and
- uses an internationally recognised framework.

The SCM methodology therefore allows HMRC to apply a standard set of principles for estimating administrative burdens across all impact assessments carried out by HMRC and HMT, meaning that published impact assessments are consistent across a range of obligations.

[97] EC Working Paper N.40 'A review and evaluation of methodologies to calculate tax compliance costs', pulished 25.10.2013

HMRC's assessment of steady-state administrative burden impacts for MTDfB was developed by considering the time businesses spend complying with HMRC tax obligations. Our approach comprised the following key steps.

Step 1: identify the key customer groups impacted by MTDfB

- HMRC identified about 3.5m businesses (including landlords) as falling within the initial phase of MTDfB. This population excludes those businesses covered by the under £10,000 exemption and incorporated businesses (our modelling did not consider more complex businesses or those subject to corporation tax because the policy design for these areas will be subject to further consultation in 2017). This population impacted by MTDfB was then segmented into business size: small, including nano and micro (c. 3.4m); medium (c. 0.04m); large (c. 0.01m).
- Within this impacted population, we isolated three main customer groups: (1) sole traders under Income Tax Self-Assessment; (2) simple partnerships under Income Tax Self-Assessment; (3) unincorporated businesses subject to VAT (these businesses are likely to span all three business segments identified above).

Step 2: analysis of the customer journey for each of the three groups

- For each of the three customer groups, we mapped every tax obligation from gathering and then providing HMRC with the information required for the current Income Tax return, completing a partnership tax return, making payments on account of income tax and Class 4 National Insurance , submitting a VAT return, etc.
- Having mapped the obligations and processes through these customer journeys, we used this to review and consider the full list of obligations incorporated in the SCM now for each of these three journeys. This identified that customers currently meet over 100 separate obligations across the three journeys. We then identified just over 80 of the current obligations which MTD may either remove, reduce or otherwise affect.
- We reviewed each of these obligations, within the context of each of the mapped customer journeys, to understand how the new MTDfB requirements might change the current 'time taken' data ascribed to each of the obligations in the current SCM database i.e. our obligations review compared the 'As is' and the 'To be' positions.
- HMRC recognised that some businesses will already be using record-keeping and accountancy software (about a quarter of the identified population), whereas others will be operating largely paper-based systems including the use of spreadsheets, and we took account of this in our modelling and assessment of impacts.
- HMRC's ongoing and extensive engagement with a wide range of stakeholders, our close working with the software developer community to better understand the potential and the capabilities of the new MTDfB software products being developed to help businesses meet the new requirements, and our awareness of the detail of the MTDfB policy design, meant that we were better able to use this insight, understanding and knowledge to determine the potential impact of the MTDfB reforms between the two positions described above ('As is' and 'To be') than we were able to do for the initial impact assessment published last year. At the end of this stage of the detailed review of the impacted obligations, we applied a reduction factor to our estimates to eliminate the potential for optimism bias; the reduction factors here were 25% for the Income Tax Self-Assessment (ITSA) obligations and 50% for the VAT obligations.

Step 3: application across the identified business population

- The estimated reduction or increase in time was applied across the unincorporated business population as a whole.
- The SCM methodology incorporates standard adjustments to account for business sizes, digital capability and agent usage.
- The overall SCM methodology was applied to apportion and average the estimated impacts across each relevant business population segment (small, medium, large).

To summarise, HMRC's assessment of the administrative burdens impacts here considered all the relevant tax and National Insurance obligations for the identified unincorporated business population.

Administrative burden impacts

Applying the SCM methodology, HMRC estimated that there would be ongoing savings in businesses' administrative costs (a combination of an overall reduction in time spent complying with existing ITSA and VAT obligations, plus the complete removal of certain obligations).

HMRC believes that the new MTDfB software products will be user-friendly, and that these integrated software products will cope with all of the required processes much more effectively than the current largely paper-based systems.

It is these paper-based systems – or in many cases no proper systems at all – which combined with the long time lag between when transactions occur and when the provision of business income and other related information needs to be made to HMRC that leads to the time wasted by both businesses and their agents in recollecting the details of particular transactions many months after they actually took place.

HMRC expects the new integrated MTDfB software products to provide for the automatic categorisation and summarisation of income and expenditure (we understand that many existing accounting and tax software products already offer this level of functionality). The integrated accounting record keeping and tax software should ensure that the quarterly updates and end of period activity will be a simple straightforward process. The software should ensure that routine work will be done automatically.

Furthermore, HMRC has made clear that there is no requirement to make tax adjustments or prepare accounts each quarter. All this will help manage the impact on those businesses and their agents who are busier at one time of the year than another. Additionally, reducing the amount of avoidable errors will reduce the cost, uncertainty, worry and time that businesses and their agents face when HMRC is forced to intervene to put things right.

These ongoing savings in businesses' administrative costs were estimated by HMRC at £270 million. Savings are assumed to apply when all relevant businesses are making full use of software capabilities, i.e. they are in steady-state. A breakdown of these overall administrative burden savings (from steady state in 2021/22) is set out below.

Table 1: Steady-state administrative burden savings

Business size	**£m**
Small (incl. nano / micro)	240
Medium	10
Large	20
Total (£m)	**270**

* The presented figures have been individually rounded to the nearest £10m, therefore the totals may not sum due to this rounding

Steady-state cost impacts

Our approach on the steady-state cost impacts assumed:

- a multi-year transitional period for businesses;

- steady-state achieved from 2021/22 when all unincorporated businesses will be within MTDfB;
- transitional costs being incurred by a business in their year of transition only (which will of course vary per business);
- the inclusion of ongoing software subscription / purchase costs (software upgrade costs are captured in the transitional cost estimates);
- no steady-state additional costs in relation to agents or accountancy fees from 2021/22 (see additional comments below); and
- steady-state costs excluding training and familiarisation or the purchase / upgrade of hardware (see comments below – all these appear in transitional costs).

On agents or accountancy fees post the multi-year transitional period, HMRC took account of the responses received during the consultation as well as discussions with stakeholders, and we assumed that, in steady state from 2021/22, accountants and businesses would be familiar with the necessary MTDfB requirements and processes, and that competition in the agents' market should mean that there would be no overall increase in agents or accountancy fees after the transitional period.

This assumption is supported by HMRC's experience with Real Time Information (RTI) for PAYE, where concerns of multiplied agents' fees did not materialise. Furthermore, HMRC's experience with VAT and ITSA is also instructive. With VAT, we have seen businesses with a lower agent penetration than in ITSA make regular returns of information derived from business records by themselves while with ITSA, there is high agent penetration for the annual returns of computed profits. Frequency of interaction seems to lead to lower use of agents.

HMRC's assessment of steady-state costs not including training and familiarisation or the purchase / upgrade of hardware takes account of the responses received during the consultation.

New MTDfB obligations

We also considered whether the MTDfB requirements introduced new obligations that needed to be incorporated into the SCM modelling, and identified two – digital record keeping and quarterly updates.

Record keeping in itself is not a new obligation in the SCM methodology, however digital record keeping is. For the purposes of the impact assessment, we have assumed that digital record keeping supplants the current requirement to maintain paper records, and that it also reduces the burden of a range of other current obligations.

For the quarterly update process, as mentioned, HMRC expects that the new MTDfB software will provide for the automatic categorisation of income and expenditure so that routine work will be done automatically, and that it will produce the quarterly update using the information already captured about income and expenses. Given that there is no requirement to make tax adjustments or prepare accounts each quarter, the burden associated with quarterly updating is therefore likely to be minimal – little more than uploading the information to HMRC, although we have estimated an amount using the SCM methodology.

Table 2 below aggregates the estimated steady-state costs for ongoing software subscriptions / purchases and the additional administrative burden costs for the quarterly updates.

Table 2: estimated steady-state MTDfB costs

Steady-state ongoing costs	£m
Software subscriptions / purchases	160
Quarterly updates	20
Total (£m)	**170**

* The presented figures have been individually rounded to the nearest £10m, therefore the totals may not sum due to this rounding

Ongoing steady-state costs are therefore estimated at £170 million. Overall, this produces a net administrative burden saving of £100 million (from steady state in 2021-22).

Approach to steady-state software costs

The government is committed to ensuring the availability of free software for businesses with the most straightforward affairs, and HMRC's work with software developers suggests that there will be a range of free software available with a good level of functionality, potentially covering a significant section of the small business population.

Taking into account the broad criteria (published in our response document on 31 January 2017), and reviewing the small business population, we have assumed:

- approximately 60% of the small business population of about 3.4m businesses (about 2m businesses) will be entitled to, and will take up, the free software on offer;
- 40% of small businesses would need to subscribe / purchase new software (transitional costs for this group are covered later in this note);
- with MTDfB compatible software capable of running on most current and recent technology (potentially even a dial-up connection is sufficient to transfer data) we have assumed that businesses in the medium and large segments will not need to acquire completely new software – these businesses may find that their existing software systems may only require an upgrade (covered in the transitional costs section);
- however, we have assumed that all these businesses in the medium and large segments will still need to keep their software current and up to date through ongoing steady-state subscriptions.

HMRC estimated steady-state software costs, across the three business segments (see Table 3), based on a combination of qualitative and quantitative analysis; taking account of estimates provided by consultation respondents, commercially available software products, internal customer insight and stakeholder discussion.

Table 3: Estimated steady-state ongoing software subscription / purchase costs

Business size	£m
Small (incl. nano/micro)	150
Medium	10
Large	negligible
Total (£m)	**160**

* The presented figures have been individually rounded to the nearest £10m, therefore the totals may not sum due to this rounding (where value under £3m = negligible)

Transitional costs

The government expects most businesses to incur transitional costs in moving to the new MTDfB requirements. In arriving at these costs, HMRC considered and took account of the lessons from the introduction of Real Time Information (RTI) for PAYE. We recognise that costs will invariably differ from business to business, and the transitional cost estimates published on 31 January 2017 represent an average across the unincorporated business population

These estimated average costs were arrived at through a combination of qualitative and quantitative analysis, evidence drawn from estimates provided by consultation respondents, commercially available software products, internal customer insight and discussions with stakeholders.

Transitional costs fall into four broad categories:

1. training and familiarisation time to include both new digital tools and the new cycle for updating HMRC;
2. purchase of new hardware or the upgrade of existing hardware;
3. additional agents or accountancy costs – HMRC will also be providing guidance and support to help businesses move to the new processes;
4. upgrading existing software and apps.

Training and familiarisation costs

HMRC has been working with software developers on the development of MTDfB related products, and developers are aiming to make their products as easy to use and straightforward as possible. For those already using digital software and apps to keep their business records, there will be little change between the way they work now, and how things will work under the new system.

Medium sized and large businesses may already have sufficient staff expertise in-house in relation to software and tax which may mean that any training and familiarisation support required is reduced. Also gaining familiarisation with an app is likely to be faster than for software, so overall, for those already using digital tools and software, the MTDfB requirements may be largely intuitive. HMRC also assumed that smaller businesses would prefer to undertake any required training and familiarisation more flexibly than medium sized and large businesses.

However we recognise that there is likely to be an opportunity cost to become familiar with MTDfB. Our assumptions are that:

- Small businesses will spend on average 6 hours to familiarise themselves with MTDfB. We have applied the standard SCM wages rate.
- For medium sized businesses, we assumed 8 hours opportunity costs, plus the cost of one day training at standard market rates.
- For large businesses, we assumed 16 hours opportunity costs, plus the cost of two days training at standard market rates.

Based on those assumptions, Table 4 summarises the total transitional costs for training and familiarisation.

Table 4: Training and familiarisation costs

Business size	**£m**
Small (incl. nano/micro)	430
Medium	20
Large	10
Total (£m)	**460**

* The presented figures have been individually rounded to the nearest £10m, therefore the totals may not sum due to this rounding

Hardware costs

We know from earlier research that a large majority of businesses and agents have access to various IT hardware tools, either desktops, laptops, tablets or smartphones. Even amongst those small businesses that do not currently operate digitally, they may have equipment at home suitable for operating MTDfB software.

Ofcom's "*Communications Market Report 2016*" (published August 2016), shows 74% of semi-skilled, unskilled or non-working households have the internet at home, with the percentage being 92% for those at higher or intermediate managerial, administrative or professional levels. The ONS "*Internet Access – households and individuals: 2016*" survey (published 4 August 2016) indicated that 89% of households in Great Britain had internet access.

The Department for Business, Energy and Industrial Strategy (BEIS) research[98] indicates that 90% of zero employee businesses had access to the internet for work purposes with 59% having their own website. 95% of SME employers had access to the internet for work purposes. Further BEIS research[99] suggests that those that did not have access to the internet were most likely to be micros (5% compared to 3% of small businesses and 1% of mediums). This suggests a high level of businesses have access to the internet and the required hardware to enable this online access.

HMRC believes that VAT-registered, medium sized and large businesses are very likely to already have good or adequate IT hardware. If anything additional is required for MTDfB, this may only require a minor upgrade.

Taking into account existing research, and in arriving at the hardware costs detailed in Table 5, we have assumed:

- 10% of small business will need to acquire hardware; and 50% will need to upgrade their existing hardware; and
- for medium sized and large businesses, we have assumed around 10% will need to upgrade their hardware (none of these businesses were assumed to need to purchase hardware).

98 BIS Research Paper Number 290 - 'Longitudinal Small Business Survey Year 1 (2015): Businesses with no employees' Published May 2016
99 BIS Research Paper Number 289- 'Longitudinal Small Business Survey Year 1 (2015): SME employers' Published May 2016

Table 5: Hardware costs

Business size	£m
Small (incl. nano/micro)	330
Medium	negligible
Large	negligible
Total (£m)	**330**

* The presented figures have been individually rounded to the nearest £10m, therefore the totals may not sum due to this rounding (where value under £3m = negligible)

Additional agents or accountancy costs

Some businesses will find that the new MTDfB software means they can do more for themselves in relation to book keeping and tax. Those businesses that are recording transactions digitally may choose to make the quarterly updates themselves and final end of period activity should be a simpler process than for a business maintaining its books and records on paper. Some businesses who currently use agents for all their record keeping and tax requirements may in time use them less, or differently.

More broadly, individual partners in a partnerships will no longer have to complete a separate return where the only reason for their being in ITSA is because they are in a partnership. They should therefore save agents or accountancy costs at year end.

However, we do recognise that businesses may need reassurance in relation to the new MTDfB requirements. Medium sized and large businesses may already have sufficient expertise in-house which may mean that any additional support they require from their agents is not significant. Costs for these businesses will be negligible; much will be in house and they will be in a good position to move to digital.

In arriving at the additional agents or accountancy costs – as detailed in Table 6 – we have made the following assumptions:

- 30% of small businesses would incur additional agents or accountancy costs as they help clients prepare for MTDfB;
- 5% of small businesses would incur a slight saving; and
- for medium sized and large businesses, 50% would incur additional fees.

Table 6: Additional agents or accountancy costs

Business size	£m
Small (incl. nano/micro)	90
Medium	5
Large	negligible
Total (£m)	**90**

* The presented figures have been individually rounded to the nearest £10m, therefore the totals may not sum due to this rounding (where value under £3m = negligible)

Software upgrade costs

As mentioned previously, the government is committed to ensuring the availability of free software for businesses with the most straightforward affairs, and HMRC's work with software developers suggests that there will be a range of free software available with a good level of functionality.

Our modelling therefore took into consideration the proportion of businesses that would be using free or paid software. Those using free software are assumed to incur no additional costs. It was assumed that all medium sized and large businesses would need to upgrade their software.

Table 7 below sets out our estimate of these software upgrade costs, and which assume:

- 10% of small businesses would need to pay to upgrade their software (in the section on steady-state costs, we assumed that 40% of small businesses would need to subscribe / purchase software, and here for transitional costs, we make the further assumption that of this 40%, 25% i.e. 10% of this particular population will also need to pay to upgrade their software as well); and
- for medium sized and large businesses, we assumed 100% of these two populations would need to do so.

Table 7: Software upgrade costs

Business size	**£m**
Small (incl. nano/micro)	10
Medium	50
Large	30
Total (£m)	**90**

* The presented figures have been individually rounded to the nearest £10m, therefore the totals may not sum due to this rounding

Summary transitional costs

HMRC estimates that, on average, businesses will incur about £280 in the year of transition, although the transition process is spread as businesses will join at different points during the period.

Transitional costs may be lower for some smaller businesses, for example those already using digital tools or those who are eligible to use free software. For those businesses that have limited existing digital capability and / or need to purchase hardware and software, costs may be higher.

We recognise that business size and digital capability are not necessarily correlated, other factors such as demographics and / or the business sector can affect this. No adjustment has been made in our estimates for wider digital benefits, for example, through productivity and efficiency improvements. Table 8 below presents the total transitional costs for MTDfB.

Table 8: Total transitional costs

Business size	**Population (m)**	**£m**
Small (incl. nano/micro)	3.4	870
Medium	0.04	80
Large	0.01	30

HMRC’s overall methodology has been discussed with the Administrative Burdens Advisory Board. HMRC believes that its methodology is comprehensive, and it reflects all the impacts from the introduction of MTDfB for those businesses paying Income Tax and VAT.

Quantitative estimates of the one-off transitional costs and steady-state ongoing savings will continue to be iterated through ongoing research and consultation with businesses to ensure that these are reflective of the final software solution and MTDfB policy design, and our large scale public beta should help provide further insight.

HMRC believes that, while there will be a level of transitional impact for businesses, MTDfB will deliver clear, ongoing benefits for businesses helping them get their tax right and supporting our ambition to tackle the tax gap due to avoidable error and failure to take reasonable care.

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